The Economist

Where Europe goes from here
PAGES 13 AND 47

Boeing and Airbus collide
PAGES 52 AND 61-64

What to do about leaking data
PAGES 55 AND 57

THE EU'S EASTERN BORDERS
A SURVEY AFTER PAGE 32

JUNE 25TH-JULY 1ST 2005 www.economist.com

George's long, hot summer

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George's long, hot summer

Jun 25th 2005

Why George Bush is going to have an uncomfortable summer ... more

The world this week

Politics this week

Business this week

Letters

On Islam, banking, Jewish history, Arthur Andersen, tobacco, Hamilton Naki, Latin

Leaders

The US presidency

Boeing and Airbus

After the Brussels summit

Support for carbon trading is growing in America

Democracy in the Middle East

How to prevent privacy breaches

Special Report

America's religious right

Britain

British pension reform

The boom in private tuition

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A survey of the EU's eastern borders

Meet the neighbours

Transformed

Climate change

Taming the Balkans

A bearish outlook

Too big to handle?

The 4% solution

The shape of things to come

Sources and acknowledgments

Offer to readers

Business

Information security

The CrackBerry backlash

An end to the Reliance feud

PREVIOUS

Jun 18th
Jun 11th
Jun 4th
May 28t
May 21s

More pri covers

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Help Hume beat Marx

Banning religious hatred

Protecting the countryside

Juries and fraud trials

Popular premium bonds

Britain's new European consensus

Europe

After the ill-tempered row at the European summit

Jacques Chirac at the EU summit

Manuel Fraga may have lost in Galicia

Christians are being harassed in Turkey

The elections to the French Council for the Muslim Faith

Russia's economy

Luxembourg's out-of-touch prime minister

United States

George Bush defends his patch

A Klansman convicted in Mississippi

The Texas governor's race

Aid to poor countries

America and Vietnam

How others see America

The Democrats best hope

The Americas

Formula One crashes in America

Punishing bosses in America

Australia's toughest corporate job

Germany's energy crisis

Adland's bitter feud

Fu Chengyu and China's energy

Special Report

Boeing v Airbus

Going Japanese

Finance and Economics

The value of Wall Street

Oil flirts with $60

The EU reforms its sugar subsidies

A derivatives battle, round two

The woes of KPMG

Eliot Spitzer and America's banks

Spendthrift America

China's exchange rate

Science and Technology

The cosmic neutrino background

Combating cancer with neural networks

Simian economics

Escaping from towering infernos

Brazil's bribery scandal

Cuba's crackdown on private business

Colombia's Uribe seeks a second term

Re-opening Argentina's “dirty war” trials

Chile's new environmental debate

Middle East & Africa

The Israeli-Palestinian summit

Palestinians on the occupied West Bank

The final round of Lebanon's general election

The run-off for Iran's presidency

Foreign fighters in the Iraqi jihad

The UN should not abandon fragile Sierra Leone

South Africa gets a new deputy president

Asia

China's land disputes

Sri Lanka's glimpse of peace

India's posh poachers

Indonesia's local elections

Australia's asylum-seekers

Books and Arts

Horatio Nelson

Bill Clinton

New Chinese art

Hillary Clinton

Obesity in America

Obituary

Lillian Lux, star of the Yiddish theatre

Economic and Financial Indicators

Overview

Output, demand and jobs

Prices and wages

Sweden

Money and interest rates

The Economist commodity price index

Stockmarkets

Trade, exchange rates and budgets

Government budget balances

Emerging-Market Indicators

Overview

Oil reserves

Economy

Financial markets

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Politics this week

Jun 23rd 2005
From The Economist print edition

Iran's presidential election

AP

Iran was poised on June 24th to elect a president in the second round of its election. Akbar Hashemi Rafsanjani, a former president running as a pragmatic conservative who can do business with the Americans, won the first round, with 21% of votes cast, ahead of a religious conservative, Mahmoud Ahmadinejad, Tehran's conservative mayor, with 19.5%. Mehdi Karrubi, a reform-minded cleric who came third, cried foul.

See article

At the end of four rounds of elections in **Lebanon**, an anti-Syrian block led by Saad Hariri, a son of the assassinated former prime minister, Rafik Hariri, won a majority of seats, though perhaps not enough to change the constitution to oust the pro-Syrian president, Emile Lahoud.

See article

An **Iraqi** constitutional drafting committee was being reshaped. The 55 drafters included 15 Sunni Arabs, along with a further ten Sunni Arab “consultants”, recruited in the hope of bringing more Sunnis into peaceful politics and undercutting the insurgents. Meanwhile, more than 80 countries and organisations met in Brussels at the invitation of the European Union and America to discuss ways to advance Iraq's recovery.

See article

Israel's prime minister, Ariel Sharon, and the **Palestinian** president, Mahmoud Abbas, met in Jerusalem for the first time since agreeing to a truce four months ago, but failed to settle several issues to do with Israel's withdrawal from the Gaza strip, due to start in August. A wave of Palestinian attacks and the arrest by Israel of at least 50 Islamist militants preceded the frosty meeting.

See article

South Africa's president, Thabo Mbeki, named his minerals and energy minister, Phumzile Mlambo-Ngcuka, as his vice-president, after the sacking last week of Jacob Zuma for his association with a businessman convicted of corruption.

See article

Making waves

Two **Taiwanese warships** visited disputed fishing waters that are claimed by Japan, China and Taiwan after Taiwanese fishermen reported harassment by Japan. Taiwan said it had the right to defend its sovereignty.

Three Pakistanis were arrested in **Afghanistan** and accused of plotting to kill the former American ambassador to Afghanistan, Zalmay Khalilzad. Meanwhile, American and Afghan soldiers killed 100 militants in the country's south.

Getty Images

Phan Van Khai became the first **Vietnamese** prime minister to visit the United States since the end of the Vietnam war. George Bush supported the country's bid for membership of the World Trade Organisation and said he

would like to visit Vietnam in 2006.

See article

Kirgizstan's prime minister and acting president, Kurmanbek Bakiyev, announced that he would suspend his powers ahead of upcoming elections. A recent upsurge in political unrest has followed the ousting in March of the Central Asian country's autocratic president, Askar Akaev.

Brazilian shuffle

Brazil's president, Luiz Inácio Lula da Silva, appointed Dilma Rousseff, the energy minister and a left-leaning technocrat, as his new chief of staff. She replaces José Dirceu, long the president's closest aide, who resigned over allegations (which he denies) that the ruling Workers' Party paid monthly bribes to congressmen in return for their votes.

See article

In **Canada**, the minority Liberal government asked Parliament to sit into the summer recess in an effort to pass controversial legislation that legalises same-sex marriages.

Colombia's **Congress** approved a bill setting terms for the demobilisation of right-wing paramilitaries. Human-rights groups criticise it as too lenient. The bill's defenders say it strikes a realistic balance between peace and justice.

See article

In **Peru**, the regional president of Cusco, the former Inca capital, issued a decree declaring coca part of the “regional heritage” and its cultivation legal in three valleys. The government anti-drug agency criticised the decree and questioned its legality.

Do not proceed

Democrats in the United States Senate again stalled the confirmation of **John Bolton** as America's ambassador to the United Nations. Some Republicans called on George Bush to use his powers to override the chamber and appoint Mr Bolton on a temporary basis.

The House of Representatives approved a constitutional amendment that would give Congress the power to ban desecration of the **American flag**. The measure, which has been kicking around Congress for the past 16 years, moves to the Senate, where it needs a two-thirds majority to pass.

Edgar Ray Killen, 80, was found guilty of orchestrating the killings, in 1964, of three **civil-rights activists** in a notorious incident near Philadelphia, Mississippi. The killings were carried out by a group of local Ku Klux Klansmen.

See article

Florida's governor, Jeb Bush, called for a fresh investigation into the circumstances surrounding the collapse of **Terri Schiavo** in 1990. Congress caused a political furore in March when it tried to have a feeding-tube re-inserted into the brain-damaged woman, whose remains were interred in a cemetery this week.

Fault-lines

AFP

In the blame game after last weekend's failed **European Union summit**, most European leaders fingered Britain's Tony Blair for refusing to give up the British budget rebate. Mr Blair conceded that the rebate was an anomaly that should go, but insisted that this could happen only as part of a broad budget reform, including cuts in farm subsidies.

See article

Luxembourg decided to go ahead with a referendum on the EU constitution, even though the summit had agreed that national governments could suspend further ratification after French and Dutch voters said no.

See article

The latest in a wave of arrests of suspected Islamic **suicide bombers** around Europe came in Manchester. Similar arrests have been made in Spain, France and Germany. Most of the suspects were thought to be planning suicide-bombings in Iraq.

See article

Cosmos 1, an experimental spacecraft designed to test the use of solar-sail technology, was launched by the Planetary Society, a space advocacy group, and several other interested parties, from a submarine in the Barents Sea. Shortly afterwards, the Russian space agency said that the launching rocket had failed.

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Business this week

Jun 23rd 2005
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Punishing the bosses

John Rigas, the founder of Adelphia Communications, was sentenced to 15 years in prison for a variety of frauds relating to the cable company's bankruptcy in 2002. His son, Timothy, Adelphia's former finance chief, received 20 years (both men were convicted last July). Prosecutors hailed the tough sentences as a breakthrough in punishing corporate crime. Last week, the former boss of Tyco International, **Dennis Kozlowski**, was convicted in his fraud trial; he faces sentencing in August.

See article

Krispy Kreme Doughnuts fired six senior executives as part of its continuing internal investigation into the company's accounting practices.

An appeals court told America's **Securities and Exchange Commission** that it had to review its new rule that requires the chairman and 75% of the directors of a mutual fund board to be independent of the fund's managers. The SEC passed the rule on the basis that there is a conflict of interest that hurts investors, but the court decided that the economic costs of the regulation had not been fully considered.

It was revealed that up to 40m credit-card accounts may have been exposed to a hacker, one of the largest **data security** breaches to date. The incident took place at a processing centre in Arizona operated by CardSystems Solutions.

See article

A three-way battle between America's online brokers concluded when **Ameritrade** agreed to buy TD Waterhouse USA, a subsidiary of Canada's Toronto-Dominion Bank, in a deal worth $2.5 billion. The bank will end up with a large stake in Ameritrade. Last month, Ameritrade itself was the subject of a bid from E*Trade, a third online broker.

Morgan Stanley posted a 24% fall in net profit for the quarter ending May 31st, compared with last year. The drop was more than the troubled investment bank had estimated.

Chinese take-away?

China National Offshore Oil Corporation made an $18.5 billion bid for Unocal, an American oil company with assets in the Asia-Pacific region. In April, Unocal had struck a deal with Chevron to be bought for around $18 billion. A fierce battle for Unocal is expected.

See article

Haier, a Chinese manufacturer of domestic appliances, launched a $1.3 billion bid (in conjunction with two private-equity groups) for **Maytag**, one of America's leading makers of electric appliances. A bidding war is expected; Maytag had agreed to be bought by Ripplewood Holdings, a separate private-equity group.

POSCO, a South Korean steelmaker, signed a $12 billion deal with the Indian state of Orissa to build a mill and an iron-ore mine. It is India's largest single foreign direct investment. The move expands POSCO's ability to feed demand in China, and possibly America, where steel imports surged by 23% in the first four months of 2005, compared with the same period in 2004.

General Electric said it would streamline its 11 existing businesses into six operating units, from early

July, in order to cut costs and become more “industry focussed”.

Reliance Group, one of India's largest conglomerates, said it would split in two. Reliance is controlled by the Ambani family, who have been feuding over ownership. The compromise deal shares the myriad businesses, worth $23 billion in total, between two brothers, Anil and Mukesh. Mumbai's stockmarket reached a record high on the news.

See article

Ford cut its 2005 earnings forecast for the second time in three months. The carmaker also unveiled plans to cut 5% of its salaried workforce.

Blockbuster

AMC Entertainment, America's second-largest cinema chain, said it would buy **Loews Cineplex Entertainment**, the third-largest (the terms were not released). The deal comes amid a lacklustre box-office summer season; receipts are 11% lower compared with the same period last year (starting on May 6th).

Google confirmed it was developing an **online payment** system. Earlier, shares in eBay had dropped slightly on predictions that the new service could challenge the online auctioneer's PayPal business.

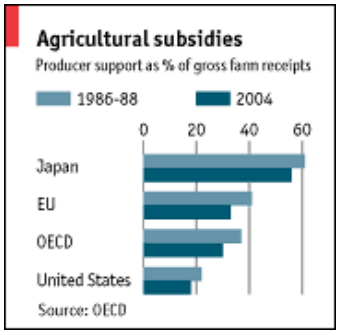
Oil prices hit a record high, closing within a whisker of $60 per barrel, before falling back. The markets are anxious that, among other things, American refineries will have trouble coping with demand later this year.

See article

Ploughing on

The OECD average for **agricultural producer support** stood at 30% of gross farm receipts in 2004, down from the mid-1980s but not much different from the mid-1990s, according to a report. The total value of the support was estimated at $280 billion in 2004, of which the EU accounted for 48%.

See article



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Letters

Jun 23rd 2005
From The Economist print edition

The Economist, 25 St James's Street, London SW1A 1HG
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Islam and democracy

SIR – You seem surprised by the failure of militant Islam in South-East Asia ("Turning back the tide", June 4th). The word "tide" itself suggests an inevitable movement that was quelled in the nick of time by liberal democracy. This is not so. If militant Islam doesn't appear to pose an immediate threat now it is because the threat was largely illusory. In the last 20 years, only Sudan and Afghanistan have had radical Islamic governments, with large swathes of their populations opposing such government (incidentally, in both cases the Islamists were funded and supported by the United States as anti-communist forces prior to taking office). You also suggest that America's recent actions have helped stem this tide with a new secular and democratic order. I fail to see how. Secularism is not going to be made popular in the Muslim world by continuing support for dictatorships such as Pervez Musharraf's Pakistan or Islam Karimov's Uzbekistan. Moreover, the implication that a positive, anti-Islamist order has been established partly by the toppling of Saddam Hussein is absurd. How have Islamists been hurt by the replacement of a stable secular regime with an impoverished, unstable, insecure democratic regime dominated by a non-secular Islamist party, with ties to Iran, and whose parliamentary politics are reminiscent of Weimar Germany?

Craig Willy
Roquefort-les-Pins, France

Online bankers

SIR – In your survey of international banking, you mentioned "e-gold" and other methods of paying online that do not involve a bank (May 21st). Unfortunately, consumers of online child pornography, and their organised criminal suppliers, have also discovered these anonymous payment methods that can neither be traced to a bank account nor to a credit card. This has been a factor in the expansion of child porn. If we don't want the virtual marketplace to degenerate into a red-light district for child porn, we must ensure that online payments can be traced back to their source. Both government and the private sector have to take responsibility and address this problem (other groups that need to transfer funds for illicit purposes are sure to follow suit). Otherwise, law agencies will find it harder to fight an exploitative trade in which only the faces and pre-adolescent bodies of the child victims can be seen, while the perpetrators conceal themselves further in the anonymity of the internet.

Juan Miguel Petit
Office of the UN High Commissioner for Human Rights
Geneva

All in the mind?

SIR – Gregory Cochran's study noted that European Jews were forced, historically, into unpopular businesses—tax and banking ("Natural genius?", June 4th). But while persecution and danger famously concentrate the mind, perhaps there is another factor in explaining Jewish intelligence. For centuries, the Jewish hero was the wise and learned student, steeped in Torah study. Such a man was a matrimonial prize; he would probably marry the daughter of another scholar and be welcomed into a well-off family as a man of status. The children would, accordingly, be bright and better fed—definite advantages in the survival stakes. This pattern, continued over many generations, might have had more effect than the pressures of persecution. Over the same period, the Church attracted similarly gifted,

spiritually searching men and women, but ensured that they remained celibate.

R.L. Hart
London

SIR – You cited Freud, Einstein and Mahler as examples of Jewish intelligence. With all due acknowledgment to Mahler's artistic genius, his impact on the world was certainly not comparable to that of Freud and Einstein. Was it by any chance "political correctness" that led you to choose Mahler rather than Karl Marx, whose impact on the world is comparable with Freud and Einstein, as your third example?

Eric Plaut
Evanston, Illinois

The company we keep

SIR – You conclude that in the case of the prosecution of the accountancy firm Arthur Andersen "it would have been better to confine any criminal charges to individuals, rather than destroy the livelihood of thousands of innocent employees" ("Reversed and remanded", June 4th). While it is regrettable that innocent employees lost their jobs, you underestimate the power of corporate elites in protecting their own. Top executives get away with unethical behaviour only because they create or contribute to a culture in which such behaviour goes unchallenged. Employees who have been recruited, patronised and pushed up the corporate ladder become friends and beneficiaries of corporate largesse and will conspire to protect their allies, however corrupt they may be. Unless an entire firm feels threatened, there is no system-wide incentive for creating an ethical culture.

Prabhu Guptara
Weinfelden, Switzerland

War on tobacco

SIR – I read with interest the news that the United States Justice Department is "seeking $10 billion from tobacco companies it accuses of a 50-year conspiracy to make smokers addicted to cigarettes" (The world this week, June 11th). As a veteran of the second world war, I remember vividly the two cigarettes that came in the small package of K ration meals given to GIs every day by the American government. Through this process, millions of us were first introduced to cigarettes and became addicted to tobacco. I often wonder if more veterans died as a result of this addiction than the 400,000 who died in combat. If the government collects billions from the tobacco companies, I think justice would be served if they shared some of it with the families of veterans who died of lung cancer.

George Marotta
Palo Alto, California

A little appreciation

SIR – Thank you for your obituary of Hamilton Naki (June 11th). When I read it, I was having what I thought was a bad day, but it lifted my veil and gave me a vision of just how good things can be, no matter what the circumstances. I am not one to be moved easily, but the obituary now hangs on my office wall. I wish I had even 10% of the sweetness of heart and mind as Mr Naki had.

Kevin Curnow
Kampala, Uganda

Ad nauseam

SIR – The letters on your use of Latin, in a recent leader on the European constitution, underline how appropriate it was to use a sentence written in a dead language, which it would seem that nobody can agree how to spell properly, as a slogan for a region with a dead document, which nobody can agree how to write (Letters, June 11th).

Ricard Rigall-I-Torrent
Girona, Spain

Sir –*Errare humanum est*. But if four readers want to correct your Latin, they'd better get their own right. The correct reversal of the American motto *E pluribus unum,* advanced by none of the four, is *Ex*

uno plura. [*Satis est*. ed.]

Stephanus Xenes
Londinium

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The presidency

George Bush's long hot summer

Jun 23rd 2005
From The Economist print edition

It should be used to rethink his ambitious second term

Reuters

GEORGE BUSH likes his summers hot. While the Clintons used to disappear to the cool breezes of Martha's Vineyard, he heads down to the furnace of Crawford, Texas, and spends an inordinate amount of time clearing brush on his ranch. This summer is likely to be sweatier than most.

Mr Bush's second term is not going well. The most visible disaster remains Iraq: the euphoria of the January election has worn off, six out of ten Americans want to bring their troops home and he has failed to get much help from the Europeans. His secretary of state, Condoleezza Rice, is (correctly) beating the drum for democracy in the Middle East; but the face of American justice remains the internment camp at Guantánamo Bay, which Mr Bush seems unsure whether to close. A new Pew survey of global attitudes to the United States (see article) shows hearts and minds are not being won.

Things are also going badly at home, where his approval ratings have dipped below 45% (see article). The president has spent weeks on the road, flogging his ambitious plan to overhaul the Social Security system—and nobody seems to be buying it. This week, the ever less loyal Republican Congress again held up the nomination of John Bolton, his proposed ambassador to the United Nations. Mr Bush has had to postpone his efforts to reform the tax code, and he is struggling to hold down government spending, after his first-term splurge, and also to get through a tiny Central American trade deal.

Meanwhile, his promises to bring the country together after his re-election have faded away. Both the main Republican gambles on Capitol Hill this year—trying to “save” the life of Terri Schiavo, a brain-damaged Florida woman, and trying to force the Democrats to give up the filibuster they are using to block his judicial nominations—were deeply divisive and ended in failure. Congress is even less popular than he is. And soon (maybe next week, if the ailing Chief Justice William Rehnquist retires at the end of the Supreme Court's current term) Mr Bush may have to nominate a new Supreme Court justice—plunging the country into its bitterest fight yet.

To Mr Bush's many critics, his discomfort is easy to explain: it is the sound of a flock of Texan wild turkeys coming home to roost. This most loathed of presidents is getting his come-uppance for being wrong on just about everything.

This rejoicing seems wrong on two counts. First, it is premature to write off Mr Bush: even in this fallow period, he can point to some achievements, including a partial reform of the tort system at home and

the glimmerings of an Israeli-Palestinian deal abroad. He still enjoys the support of his base: his approval ratings are 85% among Republicans. And the Democrats lack both ideas and leadership.

Second, from this newspaper's perspective, Mr Bush has not been wrong about everything. We have never shared his enthusiasm for the religious right (see article), which is one reason to watch his Supreme Court appointments nervously. And we have long regarded his approach to both fiscal policy and civil liberties as reckless: he deserves all the flak he gets over Guantánamo. But we have supported his push for democracy in the Middle East, his tough approach to the war on terror and, yes, the Iraq war; and in his domestic policy we have found things to admire, including his education reforms and his willingness to tackle Social Security.

So what is he doing wrong? Mr Bush's biggest problem remains execution—a crucial failing in one so ambitious. The mistakes vary from challenge to challenge, but they usually involve three things: mis-selling, an obstinate refusal to change course or personnel and a failure to reach out to opponents.

Baghdad and beyond

With Iraq, even Mr Bush's supporters admit that the administration exaggerated Saddam's ties to al-Qaeda. But in some ways, the current blithely optimistic doublespeak is worse. How can Mr Bush say he is “pleased with the progress” there, or Dick Cheney claim that the insurgency is “in the last throes”? Iraq is no Vietnam, but the sooner Mr Bush spells out the truth bluntly, the sooner he will recover his reputation as a straight-shooter with the American people and Congress.

With Social Security the mis-selling is more complicated. Mr Bush deserves credit both for pushing America to reform its huge entitlement system before the baby-boomers start to retire and for trying to create an “ownership society”, based around private accounts. But he has blurred the lines between the two, trying to sell private accounts as an answer to an immediate pensions crisis. In fact, Social Security will be “fixed” only by changing the entitlements or the contributions.

Recently, Mr Bush has altered course a little with pensions. But on many issues his generally admirable resoluteness has descended into pig-headed obstinacy. The only possible explanation for his determination to stick with Donald Rumsfeld, the defence secretary responsible for post-invasion planning and the disasters of Abu Ghraib and Guantánamo, is the misguided assumption that firing him would be a sign of weakness. In fact, it would be a sign that even Mr Bush's friends are accountable. The same goes for Guantánamo itself. Giving terrorist suspects a proper trial is not a risk; it is justice.

It is hard for Mr Bush to reach out beyond his natural supporters, partly because he often brings out the worst sort of unprincipled negativism in his opponents—be they Howard Dean or Jacques Chirac. But it cannot help the war on terror that so many people regard America as an unprincipled bully. At home, his tactic in the first term of beating up the Democrats, even when they supported his tax cuts, has solidified their opposition—and he is finding it difficult to get anything past them, let alone a project as large as Social Security reform.

More than anything else, Mr Bush's long hot summer represents a failed opportunity. Last November he was given not just a mandate, but a chance to reinvigorate his presidency. He did not take it. The next few months will be crucial—and not just for Mr Bush. It is not good for the world to have an American president consumed by domestic misfortune. But that is what we will have to deal with, unless Mr Bush clears the brush that threatens to overwhelm his legacy.

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Boeing and Airbus

Air war

Jun 23rd 2005
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The Boeing-Airbus trade dispute is getting worse. Here's how to solve it

AFP

AFTER four years of gloom, air travel is booming again. Traffic has beaten the previous record level of 2000. Outside America, which has particular problems, airlines are making money, despite the impact of $60-a-barrel oil on fuel costs.

Their customers' health is one reason why Boeing and Airbus walked away from last week's Paris Air Show with orders for more than 400 aircraft between them valued at about $45 billion. In all, this year, they have had orders for almost 1,200 planes. That's as good as their best-ever year, 1998.

Another reason why Boeing and Airbus are prospering, and the outlook for the airline industry has brightened, is that they are now competing fiercely. This rivalry has prompted them to offer their customers exciting new products, ranging from Airbus's double-decker super-jumbo to Boeing's long-haul medium-sized “dreamliner”. But it has also sharpened a nasty dispute about the way that Europe and America have been helping the two firms.

America accuses European governments of giving illegal subsidies to Airbus through “launch aid”—essentially loan guarantees which lower the risk of developing new models. The European Union retorts that state and federal governments in America lard Boeing with a variety of direct and indirect aid (see article). Both sides have filed complaints that are soon to grind their way through the World Trade Organisation. Both are likely to be found guilty. If that happens, both would have the right to levy huge duties on the offending products. That would be a disaster not just for Boeing and Airbus, but also for their customers.

Both sides have just agreed to begin talking again outside the WTO process. That is welcome. But they should go further, dropping their WTO lawsuits and resolving this long-running dispute once and for all.

At present, they are stuck. Europe says it won't abandon launch aid until America agrees to talk about wider issues of subsidy; America won't talk about those issues until Europe agrees to drop launch aid. Yet because both sides are at fault, a deal is possible.

Europe first

Airbus should make the first move, because launch aid is the larger and more egregious subsidy: now

that Airbus is a strong competitor to Boeing, Europe can no longer seriously argue that launch aid is needed to protect its infant civil-aviation industry and save the world from an American monopoly. The Americans should respond by agreeing to discuss all forms of direct and indirect assistance to aircraft manufacturers and their suppliers on both sides of the Atlantic.

Thereafter it should be possible to find a compromise on how to limit such subsidies. Eliminating them would be best, but that may prove impossible because governments pour money into military aerospace research, and that money inevitably benefits aerospace firms' commercial businesses as well. Making subsidies more transparent could be the basis for an agreement. Under such a deal, the Europeans would be likely to replace launch aid with aid for “blue sky” research and development. Since NASA does this for Boeing, America should be able to live with it.

Both sides have been threatening war for years. Now it is beginning to look as though it may happen. That makes it a good time for both sides to start seeing sense.

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The European Union in crisis

A way back

Jun 23rd 2005
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The right response to the summit setback should be a thorough debate about the EU's future

EVEN by the low standards of Brussels, last week's EU summit was a bad-tempered affair. European leaders hurled epithets at each other ranging from tragic and pathetic to shameful and egotistical. The outgoing president of the European Council, Jean-Claude Juncker of Luxembourg, concluded that the EU was not in crisis: it was "in deep crisis".

Most people agreed; yet the conclusion is worth a moment's reflection. After all, these comments came after the summit's failure, in a marathon session lasting until midnight, to settle the EU budget for 2007-13. Yet no multi-annual budget has ever been agreed until the spring before it came into force—meaning, in this case, March or April 2006. And every budget negotiation for 25 years has featured blazing Franco-British rows over the common agricultural policy (CAP) and the British budget rebate. In historical terms, the Brussels meeting was just business as usual—hardly a crisis.

However, Mr Juncker is still right: the EU faces a crisis, but in the proper sense of a turning-point. It springs not from a budget row that will surely be settled over the next year or so, but from the decisive rejection of the EU constitution by the voters of France and the Netherlands. The summit accepted that, since these two countries' no votes will stop the constitution coming into force, other countries should now be free to put ratification on hold. But it offered no response to the broader signal from disgruntled voters, of dissatisfaction with the EU's structure, remoteness and working methods.

The task of formulating such a response will now fall, ironically, to the man most widely vilified for the summit's budget failure: Britain's Tony Blair, who takes over the EU presidency from Mr Juncker. Mr Blair's stubborn defence of a rebate that will soon leave Britain as only ninth-biggest net contributor, as a share of national income, compared with fourth today, may be unappealing, though it is hardly worse than the battling for the CAP by France's Jacques Chirac (see article). But his broader argument, that the whole budget should be re-examined, is surely right—if only because it would be a logical corollary of a re-examination of the EU's purpose.

An early priority for Mr Blair ought to be to bring the EU closer to its citizens, a purported objective of the ill-fated constitution. He could suggest useful changes even without a new treaty. One would be for the Council of Ministers, representing national governments, to meet in public when it legislates. Another would be to put flesh on the EU's much-flouted principle of subsidiarity (acting at the lowest level of government). The European Commission might be invited to send all draft legislation to national

parliaments; if, say, a third disagree or think the matter should be dealt with at national level, the commission could promise to revise or withdraw it.

A second priority for Mr Blair must be to keep the EU's doors open to new members. This will require the EU's leaders to make a better fist than they have so far of persuading voters that further expansion is in their own interests (see our survey of the EU's eastern borders in this issue). Such a case ought to be relatively easy to make for the countries of the Balkans, where a failure to provide the stability and the path to greater prosperity promised by EU membership would cost the rest of Europe dear. But it will be a lot harder in the case of Turkey, and other countries such as Ukraine.

The third big task for Mr Blair is to encourage EU countries to stay on the path of economic reform, the only long-term way to revive growth and reduce unemployment. This too will be tricky, as many voters dislike economic reform as much as they do the EU; and they particularly hate lectures from the British. Here, however, a re-examination of the budget might help. If a start could be made in cutting the CAP, or renationalising its financing, and if cuts could be made to regional-fund spending in rich countries, more could be spent on research, education and the other goals of the EU's much-mocked Lisbon Agenda of economic reform. Such extra cash could become a useful carrot to stimulate reform, or to compensate those who might lose from it.

Lonely at the top

Mr Blair will not find his EU presidency at all easy, not least because his relations with Mr Chirac, Germany's Gerhard Schröder and several other EU leaders were so poisoned by the summit rows. But he can console himself with one thought: that he may yet outlast many of his rivals. Mr Schröder is likely to lose the election in September to Angela Merkel, who is more sympathetic to Mr Blair's aims. The unpopular Mr Chirac will last longer, but surely not beyond the presidential election in the spring of 2007. Even Mr Juncker may be on the way out: he has promised to resign if his voters reject the EU constitution in their referendum on July 10th. That might be enough to persuade even the euro-friendly folk of the grand duchy to say no.

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Global warming

Better than Kyoto

Jun 23rd 2005
From The Economist print edition

America should use the G8 summit to embrace carbon trading

ROPI

IN LESS than two weeks the leaders of the world's largest economies will meet at Gleneagles, a posh golf resort in the Scottish highlands, for the G8 summit. Astonishingly, these get-togethers have not always achieved a great deal. Since their creation 30 years ago, G8 summits have often been blown off course by random events, or been marred by empty grandstanding before the accompanying media circus.

In one way, things look more promising this year. Britain, which is currently chairing the G8, is determined that the leaders should focus on two big issues—African poverty and climate change—which are both huge problems and need to be addressed at a global level. In another way, things don't look so promising: the rich world's leaders will probably pass up on the chance to discuss the most important thing they could do to slow climate change—set up a global system for trading carbon-emissions permits. That's because George Bush is adamantly opposed to the limits on pollution that any such scheme requires.

Thanks to the implementation in February of the UN's Kyoto treaty on climate change, most of the rich world (though, notably, not America) now regulates emissions of carbon dioxide, the chief gas contributing to global warming. Carbon trading, which used to be regarded as a fantasy marriage of environmentalism and economics, is now seen as the least costly, least distorting and most effective way to curb carbon emissions.

Ironically, it was America, under Mr Bush's father, that pioneered emissions trading with an inventive scheme that solved the country's acid-rain problem at a fraction of the cost originally forecast. And it was America that argued for including market-based mechanisms in the deeply-flawed Kyoto treaty. But America has been left way behind by the second generation of emissions-trading schemes, which have been sprouting around the world.

The EU has a carbon-trading market that is already up and running. Norway, whose carbon policies predate Kyoto, is about to join the EU's trading system. Switzerland wants to join next. Canada and California, which in environmental matters regards itself as part of Europe rather than America, may eventually join too. A group of multinational firms (with cumulative emissions the size of Britain's) trade carbon at the private Chicago Climate Exchange; this exchange is now involved with one in Amsterdam. These various initiatives are working, but it could take years for them to come together into a global

market for emissions without co-operation and support from America, the world's biggest energy consumer and its biggest polluter.

Mr Bush's main objection to a global carbon-trading system is that it would involve capping America's emissions, and he believes that would undermine economic growth. There would indeed be costs, though probably not very large ones. The best estimate suggests that, if America implemented a system similar to Canada's, it would cut half a percentage point off GDP by 2025.

Anyway, Mr Bush's position is now being undermined not only by examples from abroad but also by arguments at home. Many business leaders, and some big cheeses in the Republican Party, want to embrace the idea.

Until now, most Republican senators have supported Mr Bush's opposition to any caps on emissions. But this week two different bills containing proposals for a national carbon-trading scheme were being considered by America's Senate. They attracted support from some leading Republicans. At the same time, some Republican state governors are throwing their support behind emissions curbs. American businessmen are also coming round to the idea. Earlier this month, the chief executives of some two dozen multinationals—including American firms such as Ford and Hewlett-Packard—met Tony Blair, Britain's prime minister, to ask that the G8 summit adopt a global carbon-trading system.

Mr Bush was right to declare the Kyoto treaty too heavy-handed. Its targets were unrealistic, and Congress under any president was going to turn it down; but his do-nothing reliance on “voluntary” action never looked feasible either. Climate change is happening, and global curbs on emissions will come, in Mr Bush's presidency or after it. If he were to embrace the idea of a global carbon-trading system, he would wrong-foot his critics and give America a sorely needed policy on climate change at a single stroke. What better way to give a jolt to this year's G8 summit?

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Democracy in the Middle East

Mainstreaming terrorists

Jun 23rd 2005
From The Economist print edition

Can Hamas and Hizbullah be domesticated via the ballot box?

Reuters

CONDOLEEZZA RICE, America's secretary of state, has this week been travelling the Arab world and preaching the virtues of democracy, which is a good thing. But what if Arabs cast their democratic votes for terrorists, who are a bad thing?

This is not hypothetical. It is happening right now in the heart of the Middle East. In Lebanon, Hizbullah, the Iranian-inspired “Party of God” and a certified terrorist organisation, has just done well in parliamentary elections, winning 14 seats (see article). In the Palestinian territories, the Islamists of Hamas have made gains in local elections and are poised to take a big block of seats in the delayed national ones. For understandable reasons, both developments horrify Israel and worry America. But should they? A theory now doing the rounds says that, like mobsters, terrorists can decide that they get more of what they want by going legitimate.

From afar (and, to their victims, from close up) the Middle East's terrorists look much the same: bloody and implacable bands that should be pounded, not appeased. But it is wrong to lump them all together. Like al-Qaeda, Hizbullah and Hamas have unacceptable aims (such as wanting to destroy Israel, not just drive it from the West Bank and Gaza) and use means that include the mass murder of civilians. But there are differences, too, which need to be explored, and exploited.

All politics is local?

Al-Qaeda has declared global war on “Jews and Crusaders”. Hizbullah and Hamas have local goals. Whereas al-Qaeda's followership is sprinkled thinly through the Muslim world, support for Hizbullah and Hamas is concentrated solidly among the Shias of southern Lebanon and the Palestinians of the West Bank and Gaza. Whatever motivates their leaders, the followers of Hizbullah and Hamas are not all driven by blind hatred of the West. They have reasonable and potentially fixable grievances. The Lebanese Shias seek a bigger say in a state that treated them as an underclass; the Palestinians want a state. Although a lot of Lebanese and Palestinians admire Hizbullah and Hamas for their exploits against Israel, they do not all subscribe to the leadership's wilder aims.

Hence the mobster theory: offer such people a legitimate way to get what they care about most and they may drop the more extreme aims, and give up terrorism too. It has more or less worked with Sinn Fein in Northern Ireland and it worked with Yasser Arafat, once he saw that the forceful liberation of all

Palestine was no longer realistic and that diplomacy offered better prospects. The Palestinians may have re-offended during the recent *intifada* but, according to Mahmoud Abbas, their new president, they are back on the straight and narrow.

Can Hamas and Hizbullah be tempted the same way? Hamas never accepted the Arafat compromise. But it will come under growing pressure to do so as it advances via the ballot box into the Palestinian mainstream. This is because the mainstream does not buy the line that Israel can be wiped off the map. Any organisation that aspires to lead it must therefore offer more than endless struggle. With Arafat out of the way, and a chance to run the Gaza strip when Israel leaves in August, Hamas really can now aspire to lead the Palestinians. Power, however, brings responsibility. When a terrorist becomes a mayor it is not just his title that changes: he has also to repair the sewerage. By the same token, Hamas ministers who joined Mr Abbas's cabinet would be pushed by many Palestinians, not just outsiders, to keep diplomacy alive by honouring the Palestinian Authority's agreements with Israel.

Hizbullah faces a similar dilemma. Now that both Syria's and Israel's armies have at last left it, Lebanon is becoming a normal country, one that does not like political parties having private armies. Hizbullah's excuse for keeping Lebanon's last one is paling in the absence of an Israeli occupation to resist. Though nobody can force Hizbullah to disarm, its refusal to do so, plus its declared aim of destroying Israel, deprives it of the respectability that is otherwise within reach.

In principle, this is the perfect moment to apply the mobster theory. Western governments should hold their noses and offer formal contacts with both Hizbullah and Hamas. Turning these organisations into solid citizens would strike a heavy blow against al-Qaeda and Islamic terrorism in general.

Unfortunately, the issue is not quite that clear-cut. If you have to choose between being a political party and a terrorist organisation, you may choose to be a party. But what if you can get away with being both? A Hamas that became a legitimate part of the Palestinian Authority but persisted with terrorism, and a Hizbullah which as part of the Lebanese state pursued its crusade against Israel, would plunge the area into chaos—just as the *intifada* did until Israel and America made it plain that all talking would end till the terrorism stopped.

America and Europe should therefore offer both groups the same sort of deal they offered Arafat: we will deal with you, but only if you end violence and accept Israel's right to exist. Pushing them so far against their ideological grain is bound to take time, but is still worth a serious try. If in the end the answer is negative, the world would at least have learned something useful: that these groups' extreme claims are not just rhetorical adornments. If they say yes, the next job will be to show the Palestinians, who have reasons to doubt it, that they can indeed acquire their state by peaceful means.

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Data protection

Hot data

Jun 23rd 2005
From The Economist print edition

Some simple, cheap measures could help protect personal data

IN THE information economy, data replace oil and steel as the central input, so information becomes a target for criminals. The theft of data, often involving personal information about customers and employees, is increasing dangerously fast. After a series of huge info-heists in America, culminating this month in the disclosure that data on 40m credit-card accounts were stolen from the computers of a data-processing firm based in Atlanta, Georgia, business leaders and politicians everywhere are taking notice.

Data theft accounted for over $50 billion in losses last year in America alone, according to the Federal Trade Commission. So far this year, lax information-security practices have left vulnerable the personal information—such as financial details, health records and Social Security numbers—of around 50m Americans.

Many companies are horribly sloppy about this stuff. They fail to install the latest security software; they handle data recklessly. Earlier this month Citigroup, the world's biggest financial firm, had to admit that it had lost information on 3.9m current and former customers when some unencrypted computer tapes went astray while being handled by United Parcel Service, the firm that was shipping the data. The story left some worrying questions unanswered. Why were the tapes unencrypted? And why was such sensitive information being sent via UPS, without proper safeguards?

And it is not just financial-service firms which are at risk. With the web of interlocking business relationships that is the norm among modern firms, a fault at a big data-processing firm that never actually interacts with customers can damage the reputation of all sorts of companies who draw from and feed into this supplier. The companies who deal with customers are ones whose principal asset is brand- and customer-loyalty, so they are the ones that have most at stake. The issue of data protection has therefore ceased to be a topic best left to geeks in the computer department. These days, it is a matter for chief executives and their boards of directors in almost every type of business (see article).

One reason why firms have been so remiss is that data security seems like a costly and boring chore. There are no obvious rewards for being careful, nor penalties for being careless. That may be changing, because the rash of embarrassing cases in the past few months has sharpened public awareness of the issue. But there is a role for regulators and lawmakers as well, partly just to keep the public informed about who is misusing their personal details.

Make them confess

Europe has avoided the spectacular data breaches that have been happening in America. That may be in part because it started to take the problem seriously a decade ago, and adopted a set of rules from which America could benefit. The European Union's 1995 data-protection directive requires firms to assess their data-protection practices and to document how they handle sensitive information. These simple rules have at least encouraged firms to address the issue of data security, and to justify what they are doing. But the biggest weakness of the European directive is that it does not require firms to report privacy breaches. As a result, it is impossible to say how effective it has really been.

That leads naturally to the second remedy, which may in the end prove more powerful: letting sunlight in on the problem. In America, many of the recent disclosures have been made only because California passed a law requiring firms to notify the people who have been affected by a breach of privacy. Scores of other states are thinking of introducing similar laws. At the national level, America's Congress is considering about 20 bills related to identity theft, and most of them contain disclosure requirements as well. Japan has gone all the way already: since April Japanese companies have had to make a public announcement when such breaches have taken place. America and Europe should do the same.

Some advocate tougher, direct regulation, but it would be better first to see whether a lighter touch can work. If companies can be persuaded to be more careful, things would improve a lot. Mandatory disclosure should encourage them to protect their customers', and their customers' customers', sensitive personal information—if only to stay off the front pages of newspapers.

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America's religious right

You ain't seen nothing yet

Jun 23rd 2005 | COLORADO SPRINGS, MANASSAS AND WASHINGTON, DC
From The Economist print edition

AP

Christian America's political arm is more complex and more dynamic than it first appears. And it will be hard to stop

THIS week, for the fourth year in a row, President George Bush broke from affairs of state to address the Southern Baptist Convention. He promised the strict evangelical group, which has 16m members, that he would work hard to ban gay marriage and abortion, and that their “family values” were his values, too.

After the Scopes Monkey trial in 1925, where creationist ideas were widely discredited, the idea of fundamentalists from the Bible Belt ruling the roost would have looked foolish. In the 1960s, many liberal Americans thought they had banned religion from the public square for good. Yet nowadays the president, the secretary of state and the House speaker accept the evangelical label. A packed prayer breakfast takes place every Thursday in Congress. And liberals regularly contend that one of America's two great parties is bent on creating a theocracy—backed by a solid core of somewhere between a quarter and a third of the population.

From the left, Howard Dean, the Democratic chairman, has derided the Republicans as “a party of white Christians”. John Danforth, a former Republican senator and champion of “moderate Christians”, noted in the *New York Times* last weekend that the two main political developments of the past ten years have been the rise of the Christian right and bitter partisanship–and that the two are connected.

Certainly the first five months of the second Bush presidency would seem to bear that out. The religious right played a leading role in Congress's last-minute intervention to “save” the life of Terri Schiavo, a brain-damaged Florida woman, as in the attempt to axe the filibuster tactic that Democratic senators have used to delay Mr Bush's judicial appointments. And it is likely to get much more bloody pretty quickly. In Massachusetts, Mitt Romney, the state's ambitious Republican governor, is battling to get rid of gay marriage. In California, an initiative is on the ballot to require “parental notification” for minors seeking abortion. The two most intriguing races next year both involve religious politics: in Pennsylvania, Bob Casey, one of the very few pro-life Democrats, stands a good chance of unseating Rick Santorum, the Senate's most outspoken social conservative; in Georgia, Ralph Reed, the *Wunderkind* of the Christian right, is running for lieutenant-governor.

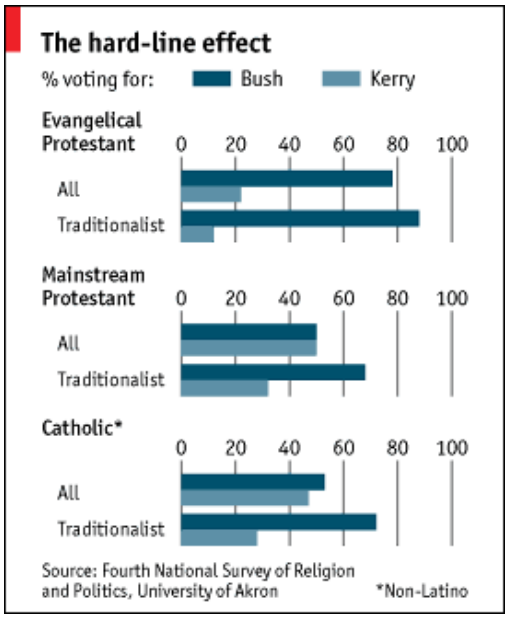
Above all, the Schiavo and filibuster battles were mere skirmishes before the all-out war, which will erupt when Mr Bush nominates a new Supreme Court justice (or two). That could happen as early as

June 27th, when the court's current session ends and the ailing chief justice, William Rehnquist, may announce his retirement.

In the beginning

Why is the religious right as powerful as it is? The question puzzles even Americans. Their country, as a whole, is not getting more religious. The gap between it and European countries has increased, but largely because of Europe's growing godlessness. Most Americans say that religion is very important (60%) or fairly important (26%) in their lives, but Karlyn Bowman, a polling analyst at the American Enterprise Institute, points out that the figures were 75% and 20% in 1952.

What has changed is, first, the make-up of Protestant America and, second, the realignment of religious America's politics. The generally liberal mainline churches have declined, while harder outfits like the Southern Baptists have spurted forward. White evangelicals, who see the Bible as the literal truth (or darned close to it), now make up 26% of the population.



It is not just a matter of numbers but of confidence. Born-again Christians are no longer rural hicks; they are richer and better educated than the average American. There are now 500 Christian colleges in America and evangelical chapters at the Ivy Leagues. Go to one of the 1,000 gleaming megachurches and the people stepping out of the four-wheel-drives in the Wal-Mart-sized car parks are software engineers, doctors and teachers.

Take, for instance, Mr Bush's friend Richard Land, who heads the Southern Baptists' public policy arm. He has stern views on moral issues; but this Princeton and Oxford-educated preacher can happily discuss the Indian economy and the flat tax. Mr Land claims that one in three of the baby-boomers now identify themselves as evangelical.

Nor, to lose another stereotype, are all the righteous white. There are some 25m black evangelicals, who seem to be moving slightly more to the right; and new immigrants, too, provide plenty of recruits. Larry Eskridge, of the Institute for the Study of American Evangelicals at Wheaton College, guesses there may be 8m Latino evangelicals. A huge number of Asian-Americans are fervent Christians, too.

The religious right also represents more than just evangelicals. At the last election Mr Bush won the Catholic vote by snaring 72% of self-styled traditionalist Catholics. Private polls also suggest that he won significant numbers of Orthodox Jews. Rather than being split between the parties, religious people of all faiths are now pretty anchored in the Republican Party. A Zogby poll last November put the national figure for “religious traditionalists” at 29%, but they accounted for 58% of Republicans.

The power of organisation

Religious America's switch to the right is rooted in two things: liberal over-reach and conservative organisation. The consistent whinge from the Christian right about “liberal activist judges” exceeding their mandate contains a kernel of truth. In the 1960s and 1970s, judges changed America from a country where every school day began with a prayer, and abortion and pornography were frowned on, to a country where school prayer was banned and both abortion and pornography were protected by the constitution.

The fact that the courts were running so far ahead of public opinion in a generally religious country bolstered the religious right in two ways. It provoked white evangelicals to join the political fray. And it persuaded all religious types to bond together. Protestants and Catholics, who used to be at loggerheads, have now found common ground, especially on abortion.

But conservative organisations have also created their own momentum. Take Focus on the Family, a sprawling empire that employs 1,400 people in Colorado Springs and claims a global audience of 220m people for its TV and radio shows, books, mass e-mails and counselling. Its founder, Jim Dobson, a former child-psychology professor, points out that the focus of his ministry's considerable energy remains family life, but its public-policy arm is growing. Focus set up a political action committee last year that spent $9m on the election, and it hurled another $1.2m at the filibuster issue earlier this year.

Focus exemplifies two of the movement's hallmarks: innovation and competition. This sophistication also extends to politics. On abortion, social conservatives have had much more success now they have stopped screaming for the practice to be made illegal (which few Americans want) and tried to limit it (which most want). There are now laws in 34 states requiring parents to be notified when a minor applies for an abortion. And Congress is considering requiring doctors to tell any woman having an abortion after 20 weeks that it will cause the fetus pain.

“You eat an apple one bite at a time,” argues Mr Land, who points out that with both gay marriage and abortion the religious right's current position is to leave decisions to state legislatures, as they are left in Europe. Messrs Land and Dobson both personally oppose gay civil unions; but their planned federal marriage amendment does not ban them because, in Mr Land's words, “it could then become a civil-rights issue rather than a marriage issue.” Mr Land enjoys turning civil-rights language back on the left, accusing the American Civil Liberties Union, for instance, of “anti-religious bigotry”.

Another sign of the religious right's sophistication is the new, and formalised, emphasis on co-ordination. The Arlington Group, a coalition of some 60 pro-family groups, began with an informal meeting of 23 leaders in Arlington, Virginia, in May 2003, but it was given a spur by a Massachusetts court's decision to uphold gay marriage in November. Now housed in the building of the Family Research Council in Washington, DC, it provided help with the state initiatives banning gay marriage last November. In January this year the group added more issues, including abortion, faith-based initiatives and judicial confirmations. Arlington also works in an ad hoc way: for instance, it brings together legal experts from its members to study court judgments.

This drive towards co-ordination is complicated by an attempt to broaden the message to issues such as the environment (“creation care”) and poverty, both traditionally associated with the left. Many leaders are suspicious about cosying up to leftish types; others see it as a way of strengthening the coalition. So far, the main alliances with the left have been in the relatively safe field of foreign policy. Rick Warren, a preacher whose “Purpose Driven Life” has sold 20m copies, recently wrote to Mr Bush urging him to cancel the debts of poorer countries, and the religious right joined up with black Democrats to pass the Sudan Peace Act in 2002.

Can't always get what you want?

The religious right's organisational prowess is impressive. But it still leaves a movement that represents a minority point of view on many issues and is just as capable of over-reaching as liberal judges are. “Some leaders of the religious right think they are far more powerful than they actually are,” argues one Republican veteran. “As religious as this country and this president are, neither wants a theocracy.”

The religious right certainly has deeper tentacles into the Bush team than into any previous administration. There is a weekly conference call with officials, and Tim Goeglein, Mr Bush's point man for social conservatives, is ubiquitous at their gatherings in Washington. But the Bush administration, which is highly sensitive to public opinion, never quite gives the religious right what it wants.

This year opened with a fairly typical dance. In a pre-inaugural interview in January, Mr Bush, citing political realities, said he would not push a

AP

federal gay-marriage amendment (which needs 60 votes in the Senate to pass). The Arlington Group then warned the White House that "this defeatist attitude" would make it impossible for the movement to unite on other difficult issues, such as privatising Social Security. The White House promptly said it was a priority, though it did not appear on a list of ten legislative priorities put forward by Republicans in the Senate.

The next wave

The religious right has won some victories, from getting PBS not to show a spin-off from "Arthur" in which his friend Buster visited a lesbian couple in Vermont, to the president dashing back across the country to sign the Schiavo bill. But there are also frustrations. Focus on the Family wants the Justice Department to do far more to enforce federal laws on obscenity. The administration wants to prosecute only the most outrageous material; Focus would rather it began prosecuting mainstream porn, which would automatically rein in the hard stuff.

Paradoxically, the very thing that worries liberals about Mr Bush—that he is an evangelical himself—gives him some room for manoeuvre with social conservatives. Too many of their footsoldiers see the president as one of their own for the leadership to beat him up. The religious right's power lies in the lower parts of the Republican machinery, in precinct meetings and the like. An incumbent Republican senator can probably stand up to them, as Senator Mike DeWine of Ohio did over the filibuster. But junior figures like his son Pat, who was defeated in a primary in Ohio shortly thereafter, are vulnerable.

What about the three big battles: abortion, gay marriage and the Supreme Court? The abortion argument is changing: Ms Bowman, the polling expert, points to a tiny increase in pro-life sentiment, which can be put down to the grisly nature of late-term or "partial-birth" abortion (which has been banned by federal law, although courts have struck the law down), the ubiquity of ultrasound equipment and maybe worries about fertility. Yet the right's opposition to embryonic stem-cell research is not popular. And when it comes to the question of overturning *Roe v Wade*, the ruling that legalised abortion, American public opinion is still against social conservatives; so Mr Bush, when asked about abortion, always waffles about appointing judges who respect the constitution. Having pushed American a little closer towards a Republican majority, Karl Rove, the president's chief strategist, does not want to throw it away on one issue.

On gay marriage, the religious right has racked up a string of successes at state level: amendments defining marriage as being between a man and a woman have passed with thumping majorities even in liberal states such as Oregon. Yet the chances of passing a federal constitutional amendment look slim.

Most Americans dislike the idea of changing the constitution. The Catholic Church, which is still recovering from its paedophile scandal, is much less trenchant on gay marriage than it is about abortion. So are young evangelicals, who dislike any appearance of intolerance. The religious right is targeting them through groups like Teen Mania Ministries, but, as Mr Eskridge points out, even the students at his own Christian university "have grown up watching 'The Simpsons'."

Tony Perkins, the president of the Family Research Council, insists that those liberal judges will inadvertently come to the right's help by overturning either the federal Defence of Marriage Act or one of the state constitutional amendments. Nebraska's law, which won the backing of 70% of voters there, recently fell foul of one federal judge. The prospect of courts overturning popular rules will force senators like Bill Nelson, a Florida Democrat who faces a tough re-election next year, to back the federal amendment.

Both abortion and gay marriage point to the centrality of the judiciary, which Mr Bush is indeed conservatising. "The average age of the judges the president has appointed is 46," one White House adviser tells a private gathering of social conservatives. "They are going to last a long time." Despite the howls from social conservatives about the filibuster deal, the Senate allowed through three judges with extremely conservative social views.

All this is a prelude to the Supreme Court. If Chief Justice Rehnquist goes, the right is confident that Mr Bush will replace him with another conservative, and probably appoint Antonin Scalia to the chief justice slot. But what happens if, say, Sandra Day O'Connor, the swing voter on many religious issues, goes as well? Mr Bush may well put up a slightly less conservative figure to reassure moderates.

And so the dance with the administration continues. But there is no doubt which way it is leading

American politics, especially from a liberal perspective. Mr Land's apple is being gradually chewed away. Can the Democrats change things?

The fightback

It could happen if the religious right over-reaches itself dramatically—by getting *Roe v Wade* struck down or, more likely, by pushing the Republicans too far to the right in the next set of presidential primaries. One reason why Congress's and Mr Bush's approval ratings have dropped is because the American public thinks they do not share its worries.

Yet if the polling numbers on matters of faith carry some warnings for the Christian right, they carry many more for the Democrats. If the last election proved anything, it was that middle America found an overtly religious party much less weird than an overtly secular one. Few lines got Mr Bush a bigger cheer on the stump than jeering at Mr Kerry's "Hollywood values".

Some liberal types now want to claim the mantle of the religious left. Hillary Clinton recently made a speech complaining about the number of abortions. The new Clintonite Centre for American Progress has a faith and progressive policy project. Jim Wallis, a chummy anti-war evangelical who wrote the best-seller, "God's Politics: Why the Right Gets it Wrong and the Left doesn't Get it", points to the huge audiences he gets around the country as evidence that many Christians want a more varied version of moral politics than just abortion and gay marriage.

There is probably something in this, but it is hard to see the Democrats seizing it. The pro-life Mr Casey in Pennsylvania is a far less typical Democrat than Mr Dean, who casually located the Book of Job in the New Testament when he ran for president. If the Republicans are the party of the over-pious, an aggressive secularism pervades many of their rivals' policies.

It seems that the religious right cannot fail to win. Either the Democrats continue to get more secular, in which case middle America will continue to vote Republican, or they will embrace religion a little more fully, and then the religious right will get a little more of what it wants.

In the hallway of the Family Research Council, there is a slightly macabre-looking exhibit of a wedding dress. Beside it is a sculpture of an eagle, with a quote from Isaiah: "Those who hope in the Lord will renew their strength. They will soar on wings like eagles; they will run and not grow weary." The religious right has a long way to go before it starts to feel tired.

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Pension reform

The shape of things to come

Jun 23rd 2005
From The Economist print edition

As the pension problem grows worse, the search for solutions is becoming pressing

TRICKY long-term political problems are a recipe for procrastination. Few come much trickier than pensions. In its second term, the Labour government put off decisions on how to ensure decent but affordable pensions for future generations. Now its third term has begun, the time has come for it to make up its mind.

A large part of the answer is likely to come from the recommendations of the Pensions Commission, set up by the government in 2002 to investigate the need for reform. In an initial report last year, the commission arrived at a bleak diagnosis of the outlook for pensioners in the 2020s if the system were left unchanged. By November, it is to prescribe the policies that have emerged from its work.

What is it likely to conclude? On June 21st the commission held a conference, attended by David Blunkett, the minister in charge of pensions, and his opposition counterparts, that hinted at its thinking.

The commission believes the case for fundamental change is now even stronger than when it issued its first report last October. Britain has historically relied upon a voluntary partnership between state and employers to provide pensions. This arrangement has enabled the government to keep state-pension spending much lower than in the rest of Europe. But a new survey of occupational pension schemes by the Government Actuary's Department (GAD) has shown just how badly the partnership is crumbling.

For the first time in the past 50 years, there are now fewer employees building up pension rights in private occupational schemes than in the public sector. Whereas all the public-sector schemes provide defined-benefit (DB) pensions linked to years of service and final salary, only three-quarters of the private-sector active members are in DB plans. Almost half of those private DB active members are in schemes now closed to new employees.

When companies close their DB schemes, they typically offer a defined-contribution plan, in which employees build up their own pot of pension money. However, contribution rates into these DC plans tend to be much lower. According to the GAD survey, the total contribution rate from employers and employees into DC schemes is 8.9% of earnings compared with 18.8% into the private DB schemes.

Adding to the misery, there were warnings this week from the head of the National Association of Pension Funds (NAPF) that there could be a fresh wave of closures of final-salary schemes, this time to existing members.

As private employers retrench, individuals are failing to step forward. Much of the blame lies with the pension credit, one of Labour's pet policies, which is damaging the incentive to save. By 2025, almost two-thirds of pensioners will be eligible for this means-tested payment, which tops up the meagre basic state pension. Since it is withdrawn at a rate of 40%, they will thus in effect be liable to the top rate of income tax on their savings income.

The pension credit has added a further layer of complexity to a system already notorious for its impenetrability. While most people grasp the basic state pension, hardly anyone has a clue about the state second pension (S2P), still less the complicated way in which it can be supplied by private providers through “contracting out”. The incomprehension is understandable: since it was established in 1978 S2P has been mauled time and again by politicians. In its latest incarnation, it is metamorphosing (over many years) from an earnings-related pension to a flat-rate one.

Faced with this tangled mess, the impulse is to urge root-and-branch simplification. For instance, the government could limit its role to providing one basic benefit for all pensioners, generous enough to

remove the need for means testing. Modelled on New Zealand's approach, this “citizen's pension” would eliminate the disincentives to save created by the pension credit and provide a platform for voluntary retirement saving.

But although this reform has been backed by the NAPF, it has not convinced the commission, partly because the basic pension would for many people in employment be very basic indeed. In a speech in May, Adair Turner, the commission's chairman, said: “If we have no earnings-related objective of policy, many people will make inadequate provision.” He pointed out that New Zealand was planning to encourage earnings-related retirement provision.

If the government wants some component of pensions to be linked to earnings, the unanswered question is whether this should be compulsory. Mandatory pension saving, introduced in Australia in 1992, would be controversial in Britain. At this week's conference, Sir Malcolm Rifkind, the Conservative pensions spokesman, called it a stealth tax and vowed that the Tories would oppose it.

One way to finesse the issue is to encourage “auto-enrolment” into pension schemes, an idea that Mr Blunkett backed. The government says 4.6m employees have the right to join an occupational scheme but have not done so. These people, seemingly as susceptible to procrastination as politicians, may stay put if they are automatically part of a scheme unless they insist otherwise. So the government may opt for voluntary measures such as auto-enrolment, with the right to impose compulsory saving if they fail.

But that is the easy bit. Longevity is rising fast, quite possibly a lot faster than most forecasts. Even with more saving, later retirement is the only way to make all the sums add up.

Not only is this unpopular, but it also raises questions of fairness, because higher socio-economic groups live several years longer than the lowest. The temptation for the government to procrastinate is not about to disappear.

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Private tuition

School's out

Jun 23rd 2005
From The Economist print edition

Education outside school is booming, and a new industry with it

IT IS big, fast-growing, largely invisible, unregulated and fragmented. But now the private-tuition industry is changing. The world's biggest private-education company, Kaplan (part of the Washington Post group) is expanding its operations. Two other providers of franchised branded teaching, Kip McGrath, a publicly quoted Australian company, and Kumon, a privately held Japanese firm, are growing fast, with more than 700 teaching centres between them. And a British firm, Fleet Tutors, has created the first nationally branded provider of home tutors.

“Private tuition has come out of the closet,” says its owner, Mylène Curtis. “Until a year and a half ago it was a covert activity: parents whispered to each that they had a tutor.” That's changed, she says, chiefly thanks to the realisation that private tuition is so widespread: the industry's best-known client is Tony Blair, whose teenage children all had private lessons to supplement their state-school education.

Such parents are the first kind of customer. They are worried that bad exam results will doom their offspring's life chances, and are increasingly distrustful of schools. “They used to say ‘I pay my taxes, and the system should educate my child',” says Alan Biggs of Kip McGrath. “Now they are realising that if they want their children to have opportunities, they need to grasp the nettle and pay the money.”

It is not a huge amount of money. Kumon, which provides proprietary maths and English teaching to 50,000 pupils at 560 centres in Britain, charges £45 ($82) per subject per month for a twice-weekly lesson and homework. Many of its customers are low-income ambitious parents from ethnic minorities. Fleet Tutors' typical customer pays £340 for 13 one-on-one lessons—one-tenth the cost of a term's fees at a private school.

The other big customer is the state, which wants remedial teaching for children who have fallen behind. Fleet Tutors, the market leader, works with 30 local education authorities and says the state is now its most important customer. Kumon is opening centres inside schools.

Estimating the size of the market is tricky. There are no official statistics. An opinion poll this week commissioned by the Sutton Trust, a charity, suggests that around 6% of pupils in the 11-16 age group received private tuition in the past year. A study last year indicated that around a quarter of all schoolchildren have private coaching at some point in their school career. Based on these figures, Fleet Tutors believes that the total turnover of the business is more than £200m, with its own market share at 11%. Neither of the other big companies has any estimate at all. “I've never sat down and thought about it,” says Mr Biggs of Kip McGrath.

But there is no doubt about the growth. Fleet Tutors' turnover rose 35% last year, though it was held back by labour shortages; Ms Curtis is trying to double her staff of 3,500 active tutors. Kip McGrath's 27 franchises in 2002 have risen to nearly 200 now, boosted, it says, by the number of teachers wanting to leave the state system and run their own business: getting a franchise going costs just £18,000. Kumon's 10% annual growth is stoked by software that finds areas with the right demographics of family size, wealth and ethnicity.

Potentially far bigger is Kaplan, a huge provider of private education to all age groups in America. In Britain, it is already the second-biggest private provider of professional training, and has another test-preparation company, mainly teaching candidates for American university-entrance exams. Last year it launched teaching for British university-entrance tests in law and medicine. It had to turn away students and has doubled the number of courses offered. Now Kaplan says it is planning further expansion, chiefly in preparing students for university admission.

Unlike private schools, which are increasingly tightly regulated, private tutors can operate freely. Although quality varies, they are best-placed to respond to those seeking flexibility, results and choice in education, and finding them lacking.

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Philosophy

Proles and polls

Jun 23rd 2005
From The Economist print edition

A spectre haunts the BBC

"DEMOCRACY is the road to socialism", wrote Karl Marx: Britons seem to agree. Communism is in disarray these days, but BBC listeners have put its top brain at the front of a poll to find history's greatest philosopher.

Charlie Taylor, the man behind the vote, said Marx had "built up a commanding lead" over Ludwig Wittgenstein, an Austrian philosopher of language, in second place.

Voters have until the first week of July to choose from a list of 20 philosophers picked by "In Our Time", a highbrow radio discussion programme. (Recent topics include theology in 12th-century Paris and "The Sublime: Defining the State of Awe".)

What explains Marx's comeback? Rick Lewis, editor of *Philosophy Now* magazine, puts it down to name recognition. Eric Hobsbawm, a Marxist historian, thinks it stems from "his liberation from the Soviet Union and prediction of globalisation". Madsen Pirie, president of the Adam Smith Institute, a libertarian think-tank, blames the voters. "The BBC audience," he says "is increasingly isolated from reality".

But, given that anyone can vote on the BBC website, there might be another explanation. Such online polls are notoriously open to meddling. *Time* Magazine's 'Person of the Century' vote was the victim of a campaign to boost Ataturk, a Turkish politician. In 1996 Labour supporters organised the vote in another BBC poll to make Tony Blair the year's outstanding figure.

Far be it from *The Economist* to suggest foul play, despite Marxists' talent for poll-rigging and ballot-stuffing. Instead, we offer advice on tactical voting. Either John Locke or Adam Smith would command our vote, but neither made the shortlist. Of those remaining, J.S. Mill, author of modern liberalism and backer of both free speech and free trade, is our natural choice. Sadly, he hasn't much hope of victory.

In their place we suggest the current third-place candidate: a liberal sceptic and empiricist, a contemporary of Adam Smith and a man with a good shot at winning. *Economist* readers seeking to stop Marx should vote for David Hume.

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Religion

Silence, blasphemers

Jun 23rd 2005
From The Economist print edition

Legislation seeking to outlaw religious hatred is redundant and counter-productive

KARL MARX saw criticism of religion as the beginning of all criticism: only when mankind had surrendered illusions about the divine could the real problems of the earth be tackled. Even as Marx loses his adherents (except among British radio listeners—see article) the legitimacy of "criticising religion" has become the target of legislators.

On June 21st, a bill to outlaw incitement to religious hatred narrowly won the approval of the Commons—after complaints it would harm free speech and a passionate appeal from a Muslim MP, who said the measure was needed to protect his family and community from extremist violence. Only by vowing to consider amendments later was the government able to avoid a big revolt from Labour critics.

The legislation sets out to punish "threatening, abusive or insulting" words or behaviour that are consciously intended to stir up religious hatred, or likely to have that effect on people. The law can be applied to plays, films and books as well as the publicly spoken word. You can offer honest ignorance of the consequences of your words or deeds as a defence—but it won't be necessary to prove that stirring up hatred was what you set out to do. People found guilty under the new law can go to jail for up to seven years.

All that sounds draconian—a sledgehammer to kill a fly, as Lord Lester, a Liberal Democrat, put it—given that inciting people to break the law is already a crime, and that, since 2001, there have been especially high penalties for "religiously aggravated" as well as "racially aggravated" crimes. Why should new legislation be needed on top of all that? The political answer is an open secret: before the election the government promised as much to Muslim voters dismayed at the war in Iraq.

But Shahid Malik, the new Labour MP for Dewsbury in the Midlands, put the Muslim case in favour of the legislation better than any lobbyist's handout could. "When I was beaten to pulp by a gang of skinheads on my first day at high school, it was not because of my religion. They did not know or care whether I was a Christian, Hindu or Muslim...we were all seen as 'Pakis'...[Now when] I am surrounded by a gang of 20 thugs...telling me I am going to die, it's because I am a Muslim." The thugs themselves understand that religion is a safer weapon because it is more acceptable than racial abuse.

One rationale for the bill is that some groups, including Jews and Sikhs, are already protected from hate-mongers because their ethnicity and their religion coincide; something must therefore be done to shield Islam, followed by people of many ethnic groups, from malice.

But opponents of the bill object strongly to the way it treats race and religion as similar categories: they say there is a positive need to protect people's right to criticise religions—which try to tell others what to believe and how to act—while "racial" criticism has no such legitimacy.

As often happens when absolute moral issues are discussed, the debate has produced some peculiar bedfellows. Liberal Christians have offered qualified support for the measure, as a gesture of solidarity with its Muslim advocates. Christians of a more red-blooded variety have lined up with secularists, convinced that there is a real threat to their right to criticise the religions they eschew.

But during the Commons debate, news came from Australia of what evangelicals may regard as the first "martyrs" created by a law designed to promote religious tolerance. Two pastors said they would rather go to jail than comply with a judge's order to apologise for an article accusing Muslims of plotting to take over the country.

Charles Clarke, the home secretary, said the Australian case reflected a harsh law in the state of

Victoria: his measure would set the bar of religious hatred much higher. For one thing, every such prosecution would require the approval of the attorney-general, and this would very rarely be given.

But critics such as the National Secular Society say the attorney-general's role may be one of most dangerous things of all, because it ensures the decision to prosecute will be political. A powerful religious campaign stands to win both ways: either the government accedes and its tormentors are punished, or it does not and believers can claim yet more “evidence” of persecution by a hostile society.

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The countryside

Land grab

Jun 23rd 2005
From The Economist print edition

Green belts won't work when they are made of elastic

ENGLAND's countryside retains its beauty partly thanks to green belts, stretches of building-free land that hem in the country's larger cities. Their purpose is to prevent the kind of sprawl that has seen Los Angeles spread 60 miles from its centre—a situation which if replicated in Britain would mean the suburbs of London nudging the English Channel.

But as cities' populations swell, planners are finding it hard to keep off the grass. This is a cause of anguish in such places as Menston, a pretty Yorkshire village bracing itself for 500 new houses on its green belt in 2009. Angela Whittaker, a pensioner whose sitting-room looks out on to rolling farmland, will soon face high-density housing for Bradford commuters instead. “I've been here 25 years because of that view,” she says, pointing towards fields shimmering in the June heat.

Her neighbour is worried about all those new commuters clogging up the station car park. It is full already, he says; they might end up having to build an ugly multi-storey garage.

Building on green belts is meant to take place only in “very special circumstances”. Even so, councils have been blithely granting builders permission for new developments. Between 2000 and 2003, some 1,070 hectares of green-belt land—about 1,500 football pitches—were converted to residential use, 8% more than during the previous four years.

This upward trend is all the more surprising given that the total amount of land converted to residential use in the same period fell by 4%. The development of the green belt for housing has grown most rapidly in the crowded South East, where 11% of new residential space was on protected countryside in 2000, compared with just 5% in 1993.

The government points out that the total amount of green belt has increased while it has been in power, growing by 19,300 hectares between 1997 and 2003, to a total of 1.7m hectares—13% of England's total area. This sounds impressive, but it is hardly a measure of success in the struggle against city sprawl, because the government has sought to offset the loss of green-belt land in the south by adding to it in the north, where development pressure is lower. Of the trumpeted 19,300 new hectares, 98.8% are in the North, North West and Yorkshire and the Humber regions. John Prescott, the deputy prime minister, has talked about having a “very tough green belt”, but so far he has been toughest in protecting areas where nobody wants to build anything.

The system of green belts is vulnerable to the incentives it creates. Because it is supposedly off-limits for building, protected land is cheap. Developers already buy “strategic land holdings”, which lack planning permission, in the hope that sooner or later they will be allowed to send in the bulldozers. Westbury, a large listed building company, has a “land bank” of 39,200 plots, 57% of which are “strategic”.

The Campaign to Protect Rural England fears this sort of speculative buying is spreading from the large house builders to general investors able to buy plots of green-belt land over the internet. It warns that this will lead to the erosion of planning restrictions, partly because landowners lobby planners in the hope that their investment will pay off and partly because absentee landlords are more likely to let their land fall into neglect, further weakening councils' desire to protect it.

Creating new green belts doesn't solve the weakness of existing ones. Until planning restrictions are properly enforced, protected land risks becoming a cheap futures market for developers.

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Jury trials

Freedom's lamp dims

Jun 23rd 2005
From The Economist print edition

Is the jury or the government to blame for the muddle in so many fraud trials?

FOR the late Lord Devlin, the jury system was more than an instrument of justice; it was "the lamp that shows that freedom lives". First developed in England and enshrined in the Magna Carta, and later adopted by America and most Commonwealth countries, it continues to enjoy huge public support.

But the government appears to prefer Mark Twain's definition of the jury system: "the most ingenious and infallible agency for defeating justice that human wisdom could contrive". This week it announced plans to scrap juries in particularly complex or lengthy serious fraud trials.

Civil liberties groups, the political opposition and most of Britain's legal profession are appalled, seeing it as the first step in a more general assault on trial by jury.

The Criminal Bar Association, representing most ordinary criminal barristers in England and Wales, argues that the right to trial by one's peers should not be abolished in any case where the defendant could be facing years in prison. "There is no single statistic or research study which suggests that trial by judge alone would be more effective or more just," it protests.

The Bar Council, representing all barristers in England and Wales, believes that poor court management is to blame for the length and cost of long fraud trials, not juries' failure to grasp complex evidence. "People trust juries. The same cannot be said for many other parts of the justice system," the council's chairman, Guy Mansfield QC, notes slyly.

Lord Thomas, shadow attorney-general for the Liberal Democrats, accuses the government of having "set out to abolish juries from the beginning. It is a tenet of New Labour to reduce juries," he says. Lord Goldsmith, his government counterpart, naturally rejects any such notion, insisting the government wants trial by jury in the "vast majority" of cases.

In fact, less than 1% of criminal cases in England and Wales ever come near a jury. Most are dealt with by lay magistrates in local courts, capable of imposing prison sentences of up to two years, or involve guilty pleas. But the length and complexity of cases that do come before juries, particularly those involving white-collar fraud, have led many to call for reform.

In March, a multi-million-pound fraud trial over the construction of the Jubilee Line on London's underground was abandoned after nearly two years when a disgruntled juror walked out. Two other jurors had already been discharged for personal reasons. The trial cost some £60m, including nearly £14m in legal-aid fees for the defence lawyers. Many jurors complained of mental and financial hardship due to the disruption to their lives.

After acquittals in high-profile trials such as that involving Robert Maxwell's empire, the case was held up as further evidence that jury trials were defective. Expressing "considerable disquiet", Lord Goldsmith ordered an inquiry into the trial's collapse. But even at the time, it was clear that the fault lay with gross mismanagement of the case, not with the jury.

A few weeks later, Lord Woolf, the Lord Chief Justice, issued guidelines to streamline all complex criminal trials so that most last no longer than three months, or six months in exceptional cases. The government has nevertheless chosen this moment—before the Jubilee Line inquiry is even complete—to announce plans to do away with jury trials in serious and complex fraud cases, arguing that they impose an "intolerable burden" upon the jury.

Provision for this had already been included in the 2003 Criminal Justice Act. But, faced with a rebellion

in the House of Lords, the government had agreed to seek further parliamentary approval before bringing the disputed section 43 into effect. Under it, the prosecution in a serious fraud case can apply for a non-jury trial where the judge is satisfied that “the length or complexity of the trial is likely to make it so burdensome upon the jury that the interests of justice so require.” The Lord Chief Justice must also give his approval.

Lord Goldsmith reckons the change would affect some 15-20 cases a year. This suggests most of cases dealt with by the Serious Fraud Office would no longer go before a jury. Responsible for prosecuting complex fraud cases involving more than £1m, the SFO completed 22 cases last year and 14 in each of the two preceding years. It boasts an average conviction rate of 70% over the past five years—which suggests juries are not an insurmountable obstacle to obtaining guilty verdicts.

American juries have certainly succeeded in convicting in recent big corporate scandals, including Bernie Ebbers of WorldCom and, last week, Tyco's Dennis Kozlowski. Indeed, they are sometimes regarded as over-zealous. Andersen's conviction in the Enron scandal was recently overturned by the Supreme Court, though that was admittedly because of the judge's wrong advice to the jury.

Lord Goldsmith says he will seek parliamentary approval for section 43 of the Criminal Justice Act after the summer recess with a view to implementing it next January. He would do better to get government lawyers first to reform their haphazard case-management and embark on jury reform only as a last resort.

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Premium Bonds

Nice little earner

Jun 23rd 2005
From The Economist print edition

The government is keen on financial competition, except for itself

PREMIUM BONDS—launched by Harold Wilson in 1957—are an ingenious form of state-run lottery. Instead of risking their stake, as in a normal lottery, bondholders gamble with interest payments, which are collected into a central fund and then doled out as prizes. Traditionally bought mainly by grannies and housewives, who owned one or two bonds in the hope of a big win, their popularity has surged in the past decade (see chart). Last week, with overflowing coffers, National Savings and Investment (NS&I), the state-funded outfit that sells them, boosted its prize payouts by offering a second top prize of £1m.

Why the rise in popularity? Partly, it's clever marketing, including bigger prizes (the first £1m jackpot was introduced in 1994). But mainly it's because of Britons' increasing financial acumen.

Many punters now see their bonds as a form of investment, with the prize rate replacing the interest payments on a normal savings account. At 3.2%, that rate is lower than those offered by banks and building societies. And, of course, it is merely an average payout: there is no guarantee that a bondholder will get that return in any given year.

But buying lots of bonds makes returns more predictable, and there are other advantages. Even hard-nosed investors like the idea of a really big win, however unlikely. The bonds are government-backed and hence risk-free. Unlike many savings accounts, which require at least a month's notice before cash can be withdrawn, Premium Bond holders can have their money back within eight days. But the biggest plus is that income from the bonds (and from many of the other financial products sold by NS&I) is tax-free. That allows a top-rate taxpayer to earn an effective return of 5.3%—higher even than savings accounts with five-year notice periods.

That annoys private firms, unable to compete with the government's tax-free offering except via Individual Savings Accounts (ISAs). “We just want a level playing-field,” says Adrian Coles, the head of the Building Societies Association. “It's interesting to note that for ISAs, where there's private competition, NS&I's market share is almost zero.” Consumers could be better served, too. With a choice of providers, savers could opt for different prize ranges, depending on their appetite for risk. And the benefits would extend to other NS&I monopolies, such as tax-free children's bonds and inflation-linked

savings certificates.

Instead, investors are stuck with whatever NS&I offers. The government has made much of its commitment to competition in financial services. Abandoning the monopoly it has created for itself would show it means what it says.

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Bagehot

Nothing left to fight over

Jun 23rd 2005
From The Economist print edition

A consensus on Europe should be good for Labour and the Tories, but there are dangers ahead for both

WHEN talking about tectonic plates shifting, a degree of caution is advisable. Just over a year ago, John Prescott, the deputy prime minister, used the metaphor in a tangled sort of way to suggest that the Labour Party was preparing for the post-Blair era. The promised seismic event never happened and Tony Blair went on to begin his third term as prime minister. But on June 20th, when Mr Blair delivered his report to MPs on the fantastically acrimonious European summit, the sound of plates grinding was unmistakable. It is beginning to look as if the aftershock from the French and Dutch referendums will have a momentous effect on the always-vexed, frequently disfiguring politics of Europe in Britain.

Mr Blair's tone and manner were almost unrecognisable. As a gifted thespian, the prime minister is a man of parts. But Mr Angry is not one he normally likes to play. Referring to the stalemate over a new budget settlement, Mr Blair remarked: “It is said that the failure to reach a deal has deepened Europe's crisis; that Europe's credibility demanded a deal. No. Europe's credibility demands the right deal—not the usual cobbled-together compromise in the early hours of the morning, but a deal that recognises the nature of the crisis. This crisis is not about the failure of Europe's leaders to reach agreement with each other. The crisis is about the failure of Europe's leaders to reach agreement with the people of Europe about the issues that concern them.” Mr Blair added, “people support the concept of the European Union. What they do not support is its present reality...”

Tory MPs cheered, chortling with delight at the once-ardently Europhile Mr Blair's repentance. But there was no less satisfaction on the Labour benches. Although most Labour MPs think of themselves as pro-European, Mr Blair's insistence on reforming the common agricultural policy as the price of giving up “the anomaly” of Britain's rebate resonates with them too. If the prime minister had simply repeated the mantra that the rebate was non-negotiable, some of his supporters might have felt uneasy at the echo of Margaret Thatcher. But the left has always loathed the CAP, seeing it as a fiendish mechanism for stifling the economic potential of the world's poorest people. Moreover, Mr Blair declared he would agree to Britain's making a bigger budget contribution if it were used to improve the prospects of the relatively impoverished new members.

Whether or not Mr Blair succeeds in making any progress on the budget during Britain's six-month presidency is almost beside the point. He now has a European cause—fairer trade policies, greater economic dynamism to tackle unemployment and further enlargement—that few in any of the main parties would take issue with. The Tories are congratulating themselves for having won the argument, but it is unclear whether it is they or Labour who will benefit most from what has happened.

Although much is made of the differences between Mr Blair and Gordon Brown over the reform of public services, the biggest source of discord between them has been over British membership of the euro. Whether Mr Blair would ever have dared to hold a referendum on the euro if his chancellor had supported entry is a moot point. Without Mr Brown's acquiescence it was always a non-starter. Mr Brown (and the Treasury) regarded Mr Blair's enthusiasm for the currency as a dangerous frivolity, while Mr Blair chafed over Mr Brown's veto.

Their spat over the euro was in effect ended before the election, with Mr Blair coming close to conceding that the chancellor might have been right all along. But Mr Brown continued to fret that Mr Blair was insufficiently robust in defending Britain's superior economic model from European hanky-panky. While Mr Blair, never one to trouble himself too much with the fine print, was quite partial to the constitution, Mr Brown's endorsement was far more grudging.

Now, for the first time as far as Europe is concerned, they find themselves united—in analysis, purpose

and even rhetoric. The speeches made by the chancellor at the Mansion House on June 22nd and by the prime minister in Brussels the following day were crafted for different audiences, but the message was identical: unless Europe responded positively to the challenges of globalisation, it would continue to fail its citizens. Mr Blair, by arguing that social Europe and economically liberal Europe are not inevitably hostile to one another, was explicitly attempting to export to Europe the Brown-Blair, New Labour synthesis. There is, however, one potential danger for the government in all of this. If Mr Blair decides that the mission to reform Europe can be accomplished only once Jacques Chirac departs the scene in 2007, he may be tempted to carry on for longer than Mr Brown can bear—with explosive consequences.

Tempting but wrong

But the Tories also face a temptation. The best course to follow is clear: to declare victory and move on. Barring something extraordinary, the integrationist project they have fought against is dying. They should welcome a new national consensus on Britain's place in Europe that does not offend Tory instincts. Although this runs a small risk of giving encouragement to the UK Independence Party, which wants Britain to leave the EU, it would demonstrate the ending of an obsession that has done the party nothing but electoral harm. It would also allow whoever is the new Tory leader to make a break with the past and to concentrate on the themes British voters actually care about.

The temptation is for the Tories to vacate the new centre ground on Europe for a more extreme position than any they have held previously—one that would entail tearing down, as some would see it, all that is left of the crumbling edifice. It's a temptation a party serious about one day winning power should resist. On past form, they will find it very hard to do so.

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The European Union summit

Of principle and pragmatism

Jun 23rd 2005 | BRUSSELS
From The Economist print edition

Reuters

Death to the constitution, but watch out for another grubby deal on the EU budget

TONY BLAIR will next week take over the presidency of the European Union for six months. For Britain's prime minister, the timing is awkward, but also opportune. On the one hand, Mr Blair's relations with other leaders (notably France's Jacques Chirac) have hit a new low, after a vicious row about the EU budget. That will make it hard for Mr Blair even to pretend to play the role of impartial chairman. On the other, the EU is in disarray and looking for new ideas and leadership. Could this be the moment when Mr Blair finally seizes control of the European agenda?

Whatever their differences, Europe's leaders agreed, after the summit collapsed at midnight on June 17th, that the EU is in a mess. Jean-Claude Juncker, prime minister of Luxembourg, who chaired the meeting, declared that Europe was in “deep crisis”. Mr Chirac echoed these words and placed the blame squarely on Mr Blair, whom he accused of “egoism”. A visibly angry Mr Blair shot back at French accusations that Britain lacked a European spirit, saying pointedly that “Europe isn't owned by anybody.” He demanded a fundamental debate on the EU's future priorities.

Will Mr Blair use his presidency to pursue this debate? Probably not. The British position on the budget is a mixture of genuine principle and tactical manoeuvring. There is no doubting Mr Blair's sincerity when he argues that it is absurd of the EU to devote almost half its annual budget of €110 billion ($130 billion) to subsidising farmers, who make up less than 5% of the population. The British have long detested the common agricultural policy (CAP). They know there is support for switching the budget to more “modern” priorities. At the end of the summit five countries—Britain, the Netherlands, Sweden, Finland and Spain—rejected the compromise put forward by Mr Juncker. Encouragingly for Mr Blair, the German opposition, which should win elections in September, is sympathetic to the idea of EU budget reform.

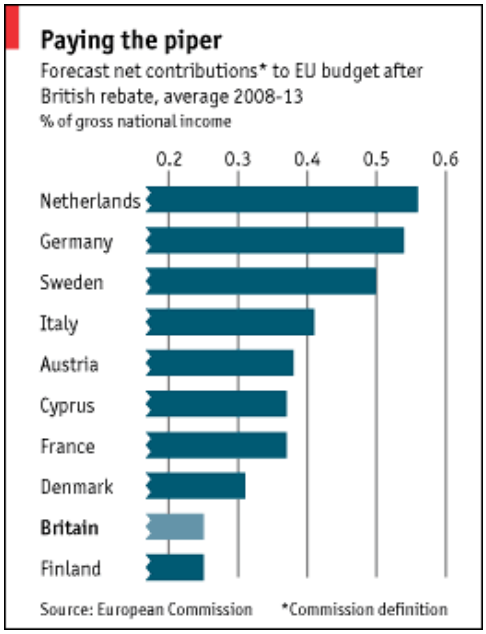
Yet the British ratcheted up the pressure for further reform of the CAP only when it became clear that Mr Chirac was determined to assault the rebate that returns to Britain some two-thirds of its net contributions to the EU budget. It seems that, if the French point a gun at the rebate, the British will do the same to the CAP. If Mr Chirac dropped his objections to the rebate, Mr Blair's demands for a review of farm subsidies would subside. In fact, because both France and Britain have made such a fuss, neither can now back down completely.

The outlines of a deal are clear. The British will keep most of their rebate; in return, they will get a commitment to a review of the CAP, perhaps in 2009 or so. Fans of Mr Blair will be disappointed if he

accepts such a business-as-usual deal, which he denounced in the House of Commons as the usual EU fudge “cobbled together in the early hours of the morning”. But Mr Blair knows the central Europeans are upset that a budget promising them billions has been delayed—and that they hate seeming to pay towards the rebate. He knows too that if a budget deal for 2007-13 is to be done in the next 12 months, the present proposal, which still devotes 40% of spending to agriculture, cannot be totally recast. The CAP might be cut—a plan to reform the sugar regime is a good start (see article)— but not to 5% of the budget.

Mr Blair has, in any case, modified his defence of the rebate. This week he conceded that it was “an anomaly that has to go”. That realism reflects how it will evolve. Britain now pays two-and-a-half times as much as France, in net terms. But if the rebate is unchanged, it will become only the ninth-largest net contributor, as a share of national income—below France, Italy and Germany, even though Britain is richer than all three (see chart).

The British prime minister has already indicated that he is prepared to give ground, and the haggling over numbers is well advanced. One diplomat says that at the summit Britain was offered a deal that would have cost it €30 billion over six years; then a deal costing €18 billion. Mr Blair countered with an offer to reduce the rebate by about €5 billion. So the final cut is likely to fall somewhere between €5 billion and €18 billion. And the higher the price Britain has to pay, the tougher it will be in its demands for a genuine, early review of CAP spending.



Although it was the budget that led to easily the bitterest rows at the summit, much of the anger and despair was actually about something quite different: the rejection of the proposed EU constitution by French and Dutch voters. Unlike rows about the budget, the constitutional rejection raises profound questions about the EU's legitimacy and underlying purpose.

EU leaders' claims to have agreed on the constitution at the summit look threadbare. Mr Juncker still insists that the constitution is alive, and might indeed come into force one day (see Charlemagne). At the same time he announced a pause in the ratification process, to allow a broader debate among European citizens. It is clear that, in Mr Juncker's mind (and he was supported by the presidents of both the commission and the European Parliament), there can be only one acceptable outcome of this debate: eventual ratification of the constitution.

But Mr Juncker's arguments are as unrealistic as they are undemocratic. He is clinging to the hope that pressure might be applied to the French and the Dutch to vote again, after a series of ratifications by other EU members. That is surely unlikely. A succession of countries have made clear that they are deferring planned referendums or parliamentary ratifications indefinitely. Denmark, Portugal, Britain, Poland and the Czech Republic have all put their referendums on hold. Only Mr Juncker's Luxembourg has decided, after much hesitation, to press ahead with a vote, on July 10th. Despite the grand duchy's moral authority in matters European, a positive verdict from its 200,000 voters, which is no certainty, is unlikely to be enough to rescue the constitution.

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France and Europe

Chirac at bay

Jun 23rd 2005 | PARIS
From The Economist print edition

The French president blames Britain for the Brussels bust-up

WHEN in trouble, pick a fight with Britain: this is a time-honoured diversionary tactic for any French politician in difficulty. But it is a measure of how deep a hole Jacques Chirac is in that his efforts to blame Britain's Tony Blair for the failure of the European summit have had only equivocal results.

Britain, snapped Mr Chirac, had been “selfish”. The talks' failure, said his spokesman, was down to “British intransigence”. Linking the British budget rebate to reform of the common agricultural policy (CAP), as Mr Blair had done, was “neither legitimate, nor justified”, Mr Chirac added. Traditionally, such a tirade against the British goes down a storm in France. Sure enough, the media that most people get their news from—television and radio—portrayed Mr Blair as summit-wrecker, clinging to his undeserved cheque. Yet the press was more ambivalent. *Le Monde* wrote of a “double victory for Mr Blair”. *Libération* called the summit Europe's Waterloo. François Hollande, the Socialist leader, mocked the centre-right president as “a monarch on his last legs”.

Mr Chirac's defence of the CAP is not as misguided a domestic political strategy as many Britons assume. True, only 4% of the French work in agriculture, but there is a strong agri-food industry. And farming looms large in French tradition, from its *terroir*-based cuisine to its flourishing local markets. According to a recent Ifop poll, 79% of the French consider their farmers to be “modern” and 68% think they are “competitive”. No mainstream politician advocates cuts in farm subsidies. As one deputy from the ruling UMP party puts it, “you can't understand French support for the CAP just by looking at economic statistics”.

It is thus unlikely that the French will budge on CAP reform, certainly in the short run. Indeed, it is precisely Mr Chirac's weakness, after 55% of French voters said no to the EU constitution in their referendum last month, that is putting him on the attack. At home, his popularity has sunk to just 28%, according to an Ifop poll, a dramatic slump from 46% in May. In the same poll, in which he usually occupies one of the top few spots, he now ranks at number 30, below a Trotskyite, a Revolutionary Communist and the Communist Party boss. Abroad too he is on ever shakier ground. Above all, he faces the prospect of a more uncertain alliance with Germany if, as expected, Angela Merkel becomes Germany's chancellor in September.

Nor, especially under a British EU presidency, is Mr Chirac likely to shift from his unyielding defence of the French social model against “ultra-liberal currents”. This is not because the French economy is withstanding them robustly. Thierry Breton, the finance minister, this week revised his growth forecast for 2005 down to 2% at best. Unemployment remains at 10.2%. But the more that Mr Blair talks of the need to face up to globalisation, the more Mr Chirac is inclined to defend social protections as an essential shelter from such cruel torrents. Ministers like Mr Breton may be emerging as a liberaliser, but the government as a whole remains more hesitant. “Globalisation is not an ideal,” declared Dominique de Villepin, the new prime minister, in his inaugural speech. “It cannot be our destiny.”

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Galicia's election

A farewell to Fraga?

Jun 23rd 2005 | SANTIAGO DE COMPOSTELA
From The Economist print edition

A Franco-era veteran who is on the brink of retirement

AFTER last weekend's Galician election, Manuel Fraga, a former minister of Franco's, called on St James, patron saint of Spain, to deliver him a last victory. Mr Fraga's centre-right People's Party (PP), which he founded after Franco's death in 1975, won 37 seats. But he needs one more to win a majority in the Galician assembly. The final result will not be known until some 70,000 votes of Galicians living abroad, mainly in Argentina and Uruguay, are counted next week.

Reuters

Don Manuel waves goodbye

If Mr Fraga, who is 82, wins a fifth successive majority, it will be a tribute to the idiosyncrasies of the conservative bastion that is Galicia, birthplace of both Franco and the present PP leader, Mariano Rajoy. It will also provide a big boost for the PP, still struggling after its loss of the general election in March 2004. Don Manuel, as Mr Fraga is known, wants to fulfil his wish to die, as Franco did, with his boots on. Yet his opponents seem more likely to win: they claim that the PP needs a whopping two-thirds of the émigré vote. The Socialists and the Galician Nationalists hope to form a coalition government, depriving Spanish politics of an historic figure who played a key role in the country's transition from dictatorship to democracy.

The Spanish left likes to portray Mr Fraga as an embarrassing anachronism. He obliges by making many absurd statements. During the campaign he told the opposition party “to eat shit” and warned voters that, when the Socialist government told them it was raining, “they are pissing on us.” He suggested that asking voters whom they would vote for was like asking women how many men they had slept with—they never give an accurate reply. And he caused outrage by saying that gays were “unnatural”.

His reputation for running Galicia with the stultifying control of an ageing despot was enhanced by a habit of falling asleep in meetings. He collapsed earlier this year during a live television broadcast. He faces criticism inside the PP for not stepping down sooner. “I know my people,” he said in an interview. “They are prudent people.” He grows irascible when asked about the Franco years. “No, I have no regrets. I did not serve during the civil war. I served in the last years of Franco.”

Mr Fraga rejects attempts to cast him in the role of villainous Francoist. He was born in Villalba in 1922, but moved aged three to Cuba as part of the flow of 2m Galicians who emigrated in the 20th century. He is a prodigious writer with an encyclopaedic memory and quixotic tendencies. In the Franco years he was a moderately progressive education minister. Later, as information minister, he relaxed censorship of the press and publishing, opening the door to democratic change—the popular refrain at the time was “with Fraga, down to the knickers”. He is, in short, credited with civilising the Spanish right.

His unorthodox ways set him apart from his peers. He recently upset PP leaders in Madrid when he rebutted their vow never to negotiate with ETA, the Basque terrorists, by revealing that he had done just that soon after Franco's death. But a new generation of voters which grew up after Mr Fraga's improvements to Galicia's infrastructure is less enthusiastic about his style of leadership. He was criticised over the *Prestige* oil spill in 2002, which devastated the local fishing industry. When it happened, he was in Castile on a hunting trip and did not hurry back.

The Socialist government in Madrid has recently needled the PP by pulling down statues of Franco. It seems that the Galician electorate may be about to consign Don Manuel to the past as well.

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Turkey and its Christians

Persecution complex

Jun 23rd 2005 | ANKARA AND MIDYAT
From The Economist print edition

A test of whether Turkey really grasps the concept of religious freedom

Is it a church? Is it a mosque?

ON THE edge of a village near Midyat is a stone building whose fate may test Turkey's commitment to the European Union. Thirty Kurdish families in Bardakci use it as a mosque. But members of Turkey's Syrian Orthodox Christian minority (or Syriacs) insist it is St Mary's church, which served their community for 200 years until civil strife and economic hardship forced them out. They want it back.

Some 3,000 Syriacs in the south-east say their land and houses have been seized, not just by Kurds, but also by the state. In Kayseri, an American couple were recently sent death threats by e-mail because they are “Christian”. A Protestant pastor in Izmit province received a menacing letter and found a red swastika painted on his door. In Tarsus, a New Zealand missionary was beaten up and then told to leave by the mayor.

“Protestants are the most persecuted group in Turkey,” says Ihsan Ozbek, pastor of the Kurtulus Protestant church in Ankara. That may be exaggerated, but respecting the religious freedom of non-Muslims will be critical to Turkey's hopes of joining the EU. For a while Turkey did well. Laws against Christians repairing churches were scrapped, enabling the Syriacs to restore the ancient Mar Gabriel monastery near Bardakci. Another law was passed to let non-Muslim religious foundations buy land. Timoteus Samuel Aktas, the metropolitan archbishop of Mar Gabriel, proudly shows off a new recreation centre for monks at his monastery. Yet recent attacks against Syriacs, including the detonation of a landmine under a car, have rung alarms—and made fellow Syriacs in Europe reconsider plans to return.

The government's failure to denounce these attacks has been aggravated by its attempts to sell land in Bardakci that the Syriacs claim as their own. They have petitioned the authorities in Ankara, who have yet to respond. Some observers see this as a sign of the “reform fatigue” bedevilling the government of Recep Tayyip Erdogan ever since he won the date of October 3rd for the start of EU membership talks. Others detect a mounting campaign against Christians by Islamist forces within Mr Erdogan's party.

One shot was fired by the state institution that micro-manages religious life in Turkey, when it issued a sermon on March 11th to be preached at some 75,000 officially registered mosques. The sermon talked of the dangers posed to national unity by missionaries, who “work as a part of a plan to cut the ties of our citizens with the [Islamic] faith.” This was followed by a statement by Mehmet Aydin, the minister for religious affairs, calling missionary activities “separatist and destructive”. He was praised by

nationalists, who fear that Europe has plans to convert Turks to Christianity. It matters little that only 300 souls have defected in the past eight years—or that proselytising is legally permitted.

Mr Erdogan still resists calls to reopen the Greek Orthodox Halki seminary on Heybeli island off Istanbul that was shut down in 1971. Allies say his hands are tied so long as he is unable to deliver on pre-electoral pledges to his pious constituents, especially to ease the ban on the Islamic headscarf in government offices, schools and universities. European diplomats counter that, by denying Christians their rights, Turkey is strengthening its growing army of detractors within the EU.

Back in Bardakci, Yusuf Ozkahraman, a 64-year-old Kurdish farmer, points smugly at St Mary's church. “Only when the Christian forces become stronger than our state will this mosque be shut to the believers, and that day will never come,” he vows.

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French Muslims

Taming Islam

Jun 23rd 2005 | PARIS
From The Economist print edition

A surprise win for moderates in elections to an official Muslim group

WHEN the French government set up a representative Muslim body two years ago, the idea was both to give Islam an official voice and to co-opt hardline groups in order to temper them. But rival elements in the French Council of the Muslim Faith (CFCM) have since bickered so much that it looked as if it might implode. So it was a surprise that on June 19th, the council's first full elections not only passed smoothly, but reinforced the moderates.

The results tilt the 43-strong CFCM board away from the Union of Islamic Organisations of France (UOIF), the most radical big Muslim group. It won ten seats, down from 13. The Paris Mosque, led by its rector, Dalil Boubakeur, upped its score from six to ten. The biggest share—19 seats, up three—went to the National Federation of French Muslims (FNMF), linked to Morocco. With tacit official backing, Mr Boubakeur is now likely to be elected to the job of president that he had held as a nominee.

The council's board was elected by 5,219 delegates from 1,230 prayer places, up from 4,042 delegates from 992 mosques in 2003. Since voting weight depends on a mosque's surface area, and many new ones have Moroccan links, this helped the FNMF. The Paris Mosque, linked to Algeria, boosted its chances in two regions by standing in alliance with a Turkish orthodox Islamic group.

The outcome may signal a wider shift in the fortunes of the UOIF, a group inspired by the Muslim Brotherhood that advocates the “Islamicisation” of society. In France, home to Europe's biggest Muslim population—some 5m strong—the group's success in recruiting young French Muslims to conservative Islam has inspired political worry. Its support for the wearing of headscarves helped prompt a ban on them in state schools. But, with the ban widely accepted, the UOIF's stock may have dipped.

Nobody would suggest, in a week that has seen a string of arrests of suspected Islamist terrorists around Europe (see article), that France has solved the problem of militant Islam. One of the UOIF's problems is a feeling among younger Muslims that it co-operates too much with officialdom. Disappointed, some are turning to more shadowy groups outside the CFCM, which has still not earned widespread legitimacy.

The CFCM's main achievements were to sink differences over the headscarf ban and unite to appeal for the release of French hostages in Iraq. But, at home, many people of North African origin reject the CFCM's narrowly clerical origins: only 5% of French Muslims go to the mosque every week. Others object to its failure to cut foreign ties. “We are not creating a French Islam,” comments Dounia Bouzar, a female member of the council, who resigned earlier this year. “We are creating diplomats.”

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Russia's economy

Told you so

Jun 23rd 2005 | MOSCOW
From The Economist print edition

Is Russia heading for "stagflation"?

STROLLING past sports-car dealerships, visitors to Moscow might think talk of the "oil curse" is overblown. Ditto economists impressed by Russia's macroeconomic stability since 1998. But in fact the outlook is increasingly glum. Growth in the first quarter was over two points down on last year. The official forecast for 2005 has been cut to 5.8%. And inflation hit 11.7% in 2004, and may touch 13% this year, well above the (revised) target of 10%.

The underlying trouble is that high oil prices, even at $60 a barrel, no longer compensate for the poverty of policy in Russia. After climbing for nearly five years, oil production began to stagnate last autumn. One reason is that oil companies now have to look beyond the easy-to-tap oil reserves of western Siberia for new fields. But another is a loss of confidence after the government's assault on Yukos, an oil firm, and its boss, Mikhail Khodorkovsky. Choked export routes and high windfall taxes are also blamed for flat oil output.

Even as petrodollars have strengthened the rouble, damaging competitiveness, the reforms that might have offset this have been glacial. An OECD report out this week says business still faces too many rules, changed too often and capriciously applied—as any small businessman would readily affirm. The justice system is shameful. The gas, electricity and railway industries are dominated by inefficient and opaque monopolies. (This week the government was due to buy a further 10.7% of Gazprom, the biggest and most opaque, for $7.1 billion, taking its stake above 50%.) The trend, says the OECD politely, is towards "more interventionist, less rule-governed state behaviour."

Opinions differ as to why Vladimir Putin, who seemed keen on reform in his first term, has more or less given up in his second. Has oil money induced complacency? Is it his authoritarian streak that led him to appoint an inert prime minister? Whatever the explanation, the government is missing a chance for relatively painless change. Given the storm over one reform that was tried—the monetisation of some in-kind social benefits—and the anxiety in the Kremlin over the presidential succession in 2008, that chance may now disappear altogether.

Along with post-Yukos jitters, stalled reform helps to account for Russia's stampeding capital flight, which, reckons Fitch, a rating agency, was a net $33 billion last year. Fear of bureaucratic attacks also explains a spate of Russian flotations, often of smallish stakes, in London. The thinking is that foreign investors offer some protection against government predation (though they availed Yukos little, and the theory relies on moderately good relations between Russia and the West).

Nervous Russian cash heading out; naive foreign loans still coming in: so it was before the default and devaluation of 1998. That may be a comparison too far. Russia has run trade and budget surpluses for five years. So far, the oil-windfall revenues in its stabilisation fund have not been used except to pay off debt, which the president seems to regard as an affront to Russia's pride. Mr Putin realises that his hope of transforming living standards is fading: he periodically berates his ministers, ordering them to get growth numbers up and inflation down. But such harangues only exemplify the instinctive dirigisme that is a big part of Russia's problem.

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Charlemagne

The delusions of Mr Juncker

Jun 23rd 2005
From The Economist print edition

Introducing the Louis XVI prize, for being out of touch

EVERY year the city of Aachen, in Germany, awards the Charlemagne prize, to the person whom it deems to have done the most to promote the cause of European unity. This column, repeatedly snubbed by the good burghers of Aachen, has decided to start a new award: the Louis XVI prize, to be given to the European leader who seems most out of touch with reality. It is named in honour of the French monarch whose diary entry on July 14th 1789, the day the Bastille was stormed, read *Rien* (nothing). And the first winner is Jean-Claude Juncker, prime minister of Luxembourg and current president of the European Union. "I do not believe the French or the Dutch voters rejected the European constitution," declared Mr Juncker sonorously at last weekend's EU summit. This magnificent refusal to acknowledge two widely reported news events makes him a worthy recipient of the new award.

Of course Mr Juncker knows perfectly well that French and Dutch voters actually voted against the EU constitution, and in impressively large numbers. But, as he explained, the voters were expressing anxieties that were in fact dealt with in the constitution—if only they had realised it. Therefore, they cannot really be said to have rejected the constitution. It was all a mistake. It is a safe bet that, had the French and Dutch voted in favour of the constitution, Mr Juncker would not have felt bound to submit their verdict to such a tortured analysis. But to be fair to him, he is not alone. Indeed, all 25 EU leaders at the summit put their names to a joint declaration which "noted" the results of the French and Dutch referendums, but then asserted that these results "do not call into question citizens' attachment to the construction of Europe". Perish the thought.

That Mr Juncker is not uniquely delusional suggests that there will be no shortage of future contenders for the Louis XVI prize. Indeed, at the very same summit, France's president, Jacques Chirac, made a worthy run of his own, with his statement that the common agricultural policy, a system of farm subsidies rooted in the 1950s, a time of peasants and worries about food security, was a "modern and dynamic policy".

Going back a bit, the European Commission's statements on the stability and growth pact, which was designed to limit the budget deficits of countries in the euro, the single European currency, are another example of wishful thinking masquerading as policy. The commission insists that the pact is alive and well, even though budget deficits are soaring across the EU and most economists consider the pact to be about as alive and well as the EU constitution. Indeed, economic policy provides particularly rich pickings for those searching for EU statements that defy reality. How about the repeated assertions by European leaders at and after the Lisbon summit in 2000 that the EU must become the "most competitive and dynamic knowledge-based economy in the world by 2010"? At least that aspiration has been dropped, as the date draws uncomfortably near.

Defenders of Europe's leaders might argue that, in every case cited above, there is a logic behind such apparently bizarre statements. The commission must insist that the stability pact is still going, because to acknowledge its death would risk encouraging a real fiscal free-for-all. Mr Chirac has to defend the CAP, because of the budgetary benefits it brings to France. The target of economic supremacy by 2010 was a worthy attempt to galvanise Europeans into action. As for the insistence by Mr Juncker and others that the EU constitution lives on, this is an understandable effort to sustain the great dream of European political union, which has animated leaders such as Mr Juncker for many years. Anyway, politicians everywhere deal in half-truths and slogans. Why hold Europeans to higher standards?

The answer is that a policy of denial is particularly dangerous for the EU, both because of its nature and because of recent events. It has become a cliché that a huge gap has opened up between Europe's political elite and disgruntled voters. The opinion-poll ratings of such European leaders as Mr Chirac, Gerhard Schröder of Germany and Jan Peter Balkenende of the Netherlands are all disastrously low. The

fiasco of the constitution has demonstrated clearly the growing contempt felt by many voters for the project designed and built by their political masters. If the politicians' response is simply to insist that they were right all along—or even to deny that adverse events have happened—this feeling can only increase.

A confidence trick

That should be particularly troubling for the EU, because it is a club that is based entirely on confidence and goodwill. If the idea gets around that it is a discredited organisation whose leaders are living in la-la-land, it may find it increasingly hard to impose its authority, even when it is enforcing EU law. National governments may become increasingly inclined to ignore edicts from Brussels. This process is already well under way with the destruction of the stability and growth pact. But the unravelling of the authority of the EU could, in time, extend to areas well beyond the enforcement of fiscal discipline. What would happen if tomorrow the commission were to tell Italy or France that they could not bail out troubled companies such as Alitalia or Alstom? In the current political climate, it would be tempting for the Italian or French governments simply to tell the commission to take a hike.

Such a confrontation would expose the flimsy foundations of EU power. When Little Rock refused to desegregate its schools in the 1950s, there were federal troops to enforce the will of the United States Supreme Court. Even Louis XVI had an army behind him. But the European Court of Justice and the European Commission, like the pope, have no divisions. They rely on the goodwill of EU members and the credibility of the organisation. Both are now under considerable strain.

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The presidency

On the back foot

Jun 23rd 2005 | WASHINGTON, DC
From The Economist print edition

George Bush is in less trouble than his poll ratings imply, but his presidency looks a much more defensive one in the second term

THE current occupant of the White House is the least popular re-elected president since Richard Nixon became embroiled in the Watergate fiasco. This week, according to a *New York Times* poll, just 42% of Americans approved of the job George Bush was doing. By contrast, Bill Clinton and Ronald Reagan had approval ratings of around 60% at this stage of their second terms. If this were any other president, one would be talking of a crisis of confidence.

But Mr Bush is not any president. Except for a year of stratospheric popularity after the terrorist attacks of September 11th 2001 and a shorter gust of support after war began in Iraq, he has lived almost continuously with ratings around the 50% mark. This is unusually low, and would have kept previous incumbents awake at night, shivering. Yet not only did Mr Bush win re-election with a decently increased majority but he also helped Republicans gain seats in Congress in 2002 and 2004.

The president and his officials argue that the key to success in the presidency has been resolute leadership. “My strategy is pretty simple,” he told an industry group recently. “Explain the problem to the American people, and keep explaining it and explaining it.” He was talking about his plans for Social Security, but he could have been referring to almost anything—tax cuts, Iraq, education reform. Eventually, if you make the right decision, people will come around.

Many people will howl that Mr Bush did not make the right decisions. But this style of leadership has enabled him to survive unusually high levels of discord. Indeed, ignoring opinion polls has become almost a point of honour.

What really matters, his officials say, is the ability to mobilise core supporters come election time—witness 2002 and 2004. Mr Bush's core supporters are religious and social conservatives—and there are few signs they are seriously worried now. In fact, the battle in the Senate over judicial nominees, in which the president kept insisting on floor votes in the face of Democratic filibusters, has probably solidified his support on the right.

Mr Bush can also claim he has been able to get more done in Congress than might have been expected.

The Senate has confirmed most of his judicial nominations. He has achieved one (admittedly small) part of his promised tort reform, limiting class-action lawsuits to federal rather than state courts. The budget process is moving more swiftly than usual. And this week, the Senate made some progress on his endlessly delayed energy bill (the House of Representatives has already passed its version of this pork-stuffed monstrosity). There is no guarantee the two chambers will come up with a bill ready for signing this month, as Mr Bush wants. But the prospects for something this year look better than for some time.

As a result, Mr Bush has also been able to contain one of the habitual risks for any second-term president, that the component parts of his governing coalition fly apart without the discipline of a re-election campaign. The danger is greater if you are stroking one part of your alliance, as Mr Bush is doing with religious conservatives. Some of Mr Bush's corporate backers are indeed nervous about his agenda—especially Social Security reform (businesses worry they may end up footing part of the bill). By and large, though, progress over tort reform, plus promises to make tax cuts permanent and his endeavours to pass free-trade deals have kept the moneymen in line.

Yet despite all this, those dismal poll ratings do mark a dangerous moment for the president. To see why, think of the difference between two sorts of president: the offensive and defensive kind.

All presidents want to go on the offensive. They seek to dictate the national agenda, dominate public debate and bend Congress to their will. By focusing on a few issues—tax cuts, education, and, after September 11th, the overthrow of Saddam Hussein—Mr Bush's first term epitomised the offensive presidency (in more senses than one, opponents might add).

The president started out his second term in the same vein. He laid out an unusually ambitious agenda of fundamental tax reform and Social Security privatisation. And he boasted he would spend the political capital won through re-election campaigning for these changes.

Mr Clinton wanted to go on the offensive too, but after the Republican landslide of 1994, he came to exemplify the defensive presidency—reacting to opponents and turning their initiatives to his advantage. “Triangulation” worked surprisingly well. Despite impeachment, his second term was a period of economic growth, budget surpluses and reductions in poverty rates; he even claimed the credit for welfare reform, one of several Republican demands he accepted.

The succession problem

Mr Bush cannot be defensive in the same way. His party controls both chambers of Congress, so he cannot react to his opponents' manoeuvres. There aren't any to react to anyway: on issue after issue, the Democrats have adopted a policy of “just say no”. That may end up being a mistake on their part, but this summer is already a period of greater defensiveness for Mr Bush than any point in his first term.

Because the vice-president, Dick Cheney, says he harbours no ambitions to succeed his boss, the battle to win the Republican nomination for 2008 has begun unusually early—and all conflicts involving possible successors become heats in that far-distant race. The argument about ending the Senate filibuster for judicial confirmations, for example, was widely seen as a test of will between two would-be presidents, Bill Frist, the Senate leader who wanted to stop the parliamentary tactic, and John McCain, who led the group of senators that voted in favour of the chamber's traditional practices.

Mr Bush is no longer the only voice that really matters in the Republican Party. Indeed, because he is not running again (and is unpopular to boot), members of Congress also fear he will be of less help to them in the 2006 mid-term elections than he was in 2002 and 2004. As a result, he no longer dominates Congress as he did.

The revolt of the centrist senators over the filibuster is one example. A more direct challenge to his authority came over stem cells. Defying a rare threat of a presidential veto, the House of Representatives voted last month to authorise federal money for research on new stem-cell lines. This week, the Senate failed for the second time to confirm John Bolton, Mr Bush's nominee as ambassador to the United Nations. One Republican voted with the Democrats and others are advising Mr Bush to give up and try someone else. Compounding his woes over the UN, the House also voted to halve American contributions to the international body, unless it implements dramatic reforms. So while it is true that Mr Bush has had a few legislative successes this year, he has also plainly suffered setbacks—and “win some, lose some” is hardly the motto of a president successfully on the offensive.

But perhaps the most convincing evidence that Mr Bush is being forced on to the back foot comes from

the recent fate of his signature second-term proposals. This week, he said he would support a bill, proposed by a Republican senator, Bob Bennett, to reform the Social Security system— but without introducing private accounts (the heart of his “ownership society”). Last week, Mr Bush postponed for two months the deadline for a panel of experts to produce a blueprint for fundamental tax reform. Neither action means his proposals are dead. Mr Bush insists he still wants private accounts. But both pensions and tax reform are clearly in trouble.

Learning how to defend

With “damn the torpedoes” no longer an option, how will Mr Bush fare in more defensive mode? So far, the signs are not encouraging. In case after case, the president, who describes himself as “stubborn”, has been sticking with a course of action long after it has become unsustainable. By the time he does compromise, a lot of unnecessary damage has been done.

You can see that with Social Security. Mr Bush has been stumping the country for months only to discover (as every poll says) that the more people hear about the idea, the less they like it. Proposals to change the system are now more popular if they don't have the president's name on them. Or take Iraq. Mr Bush claims that the country is making progress and the American mission will be a success. But support for the war has fallen sharply, partly because the president's optimistic bulletins have not prepared the public for a long, hard slog. Patience is running out.

Obviously, it is hard for a president to strike a balance between being flexible and not undermining his own position. But the absence of a Plan B for Iraq or Social Security (or arguably for North Korea, Iran and Guantánamo) is disturbing.

Last September, according to the *New York Times*, the president told a meeting of his richest supporters, “I'm going to come out strong after my swearing-in with fundamental tax reform, tort reform, privatising of Social Security.” A victory, he promised would give him “two years, at least, until the next midterm. We have to move quickly, because after that I'll be quacking like a duck.” At this rate, it may not take even two years.

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Civil rights

Justice, of a sort

Jun 23rd 2005
From The Economist print edition

Four decades on, Mississippi makes amends

EIGHTEEN men were originally brought to court after the killing, almost exactly 41 years ago, of three civil-rights workers in Neshoba County, Mississippi. The federal government tried them, but only on a charge of depriving the dead men of their civil rights. Edgar Ray Killen, who was convicted of manslaughter on June 21st, was the first to be charged with their murder.

He was also the first to be tried by the state of Mississippi. At the time, Mississippi turned a blind eye to the case. The accused, all Klansmen, were well known in the town. By contrast, the civil-rights workers were outsiders. Andrew Goodman and Michael Schwerner were Jews from the north. James Earl Chaney was a black from nearby Meridian. To the townsfolk they were interferers, who had come to investigate the burning of a black church and to get blacks to register to vote. They were not wanted.

Their killers would probably not have been convicted then in any state trial. Hence the trial now, to salve Mississippi's conscience. But it has been problematic. Much of the evidence has been on paper, because witnesses are dead. Memories have faded, though emotions have not. Mr Killen himself, who is 80, in a wheelchair and on oxygen, inevitably has the look of a scapegoat about him. His opponents were disappointed that he did not go down for murder; but at this distance, the evidence could not possibly convict him.

Eight other Klansmen survive of the group who carried out the killings and buried the victims, 15 feet deep. A grand jury, however, has not found enough evidence to indict them. And in any case Mr Killen's trial has probably done what Mississippi needed.

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Texas politics

Grandma v the governor

Jun 23rd 2005 | AUSTIN
From The Economist print edition

There is a gubernatorial race in Texas. Let the brawl begin

AP

Shy, retiring Texan gentlewoman seeks temporary employment

"I AM not a weak-leadin', ethics-ignorin'...promise-breakin', do-nothin' Rick Perry phoney conservative," bellowed Carole Keeton Strayhorn, Texas's state comptroller, as she joined the 2006 race for governor this week. The home state of Ann Richards has produced another woman warrior, this time on the Republican side. Mrs Strayhorn's speech, delivered in the blistering midday Texas heat, gave new meaning to her campaign slogan, "One Tough Grandma".

Mr Perry, the incumbent, can at least comfort himself that he is facing Mrs Strayhorn rather than a different Amazon. Kay Bailey Hutchison, a popular senator, announced last week that she would run for re-election rather than challenge Mr Perry in the Republican gubernatorial primary. The governorship could have positioned her for the vice-presidency in 2008, but Mrs Hutchison claimed that she was swayed by the prospect of more senior Senate posts: she plans to run for the number-four leadership post, the chairmanship of the Republican Policy Committee. The White House denies meddling, though some think it was scared of turmoil in Texas if Mrs Hutchison left. Others think she has simply wimped out of an ugly campaign.

The race will turn bloody anyway. Mr Perry, who replaced George Bush in 2001, is in trouble. On his watch the state legislature, which meets for five months every two years, has repeatedly failed to find a new and better source of finance for the schools besides property taxes. On June 18th Mr Perry announced that he had vetoed the school budget, thus forcing lawmakers back to a 30-day special session that started this week.

It is a high-stakes gamble. If the legislature cannot come up with a plan, schools may not open on time this autumn—and, asks one Texan political observer, "If school doesn't open, do you think Rick Perry will get elected?" Tougher still, the bill must be passed by a two-thirds vote if it is to take effect now; a simple majority will take 90 days to come into force—and the schools open in August. The sticking point is whether the new money for the schools should come from increases in the sales tax, or in the tax on business.

Mr Perry's approval ratings are already below 40%, and could fall further if schools do not get their money. So Mrs Strayhorn—who is the mother of Scott McClellan, the White House press secretary—stands a chance. She is slightly less conservative than Mr Perry, and has a long record of

public service, from mayor of Austin to railroad commissioner. At 65, she has “got nothing to lose so she'll swing for the fences”, says Richard Murray, a political-science professor at the University of Houston.

Much will depend on turnout in the primaries. This is usually dismal: in recent times, below 15% of voting-age Texans. If Mrs Strayhorn can persuade middle-class suburbanites, Latinos, or even Democrats (who can vote in Republican primaries in Texas) to turn out, in addition to Christian social-conservatives, she could upset Mr Perry and his slick fundraising machine.

This is not, of course, to ignore the obligatory wacky candidate. Richard “Kinky” Friedman, a mystery-writer and former leader of the Texas Jewboys band, threw his Stetson into the ring this spring. His campaign planks include abolishing political correctness and “de-wussification” (cowboys, he insists, should be regarded as heroes, not ridiculed).

Speaking of wusses, the Democrats have yet to field a candidate. Several are considering—in fact, they are sensibly biding their time to see what becomes of Mr Perry and his education gamble. If a Democrat topples Mr Perry, it will truly be a revolution for the Lone Star State.

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Aid to poor countries

MCC hammered

Jun 23rd 2005 | WASHINGTON, DC
From The Economist print edition

In praise of a bold but unloved aid agency

GEORGE BUSH's flagship foreign-aid programme is under fire. Since 2002, when the president promised to set it up, the Millennium Challenge Corporation has found only four relatively small poor countries to give money to. Last week, the MCC's chief executive, Paul Applegarth, said he was quitting to "reintroduce" himself to his wife and daughters.

The MCC is unloved by both left and right. A Republican-led House of Representatives sub-committee has just recommended nearly halving its budget, to $1.75 billion next year. American liberals suspect it is part of Mr Bush's conspiracy to conservatise the world. And Europeans mock the MCC as slower, meaner and more ideological than their own aid programmes. Some of this criticism is fair, but much is not.

The "slow" charge is accurate, though that is not the fault of the MCC's overworked staff. Congress did not pass enabling legislation until last year, and the Bush administration, distracted by Iraq, was ill-prepared even then to get the agency up and running.

At first glance, the "mean" charge seems apt, too. Mr Bush initially promised $5 billion a year to fund the MCC, but it has so far disbursed only $400,000. The agency's defence is that it is trying something new and unusual. Other donors tend to focus on tear-jerking issues such as AIDS, or on boosting the budgets of the better-run poor-country governments so they can provide better public services. The MCC seeks to promote economic growth in those countries—which is more complicated and takes more time.

Promoting economic growth also sounds a bit more conservative than the usual aid language: hence the charge that the MCC is "ideological". But since rapid growth in poor countries has consistently been accompanied by longer, healthier and more comfortable lives for their citizens, it is hardly a foolish aim.

The MCC is "uniquely transparent" about how it selects countries that qualify for its cash, according to Steve Radelet and Mvemba Dizolele of the Centre for Global Development, a think-tank. To be considered, a country must be poor: ie, its income per head must be $1,400 or less (though some middle-income countries will be considered next year). It must also meet minimum standards of political and economic freedom (as measured by various independent watchdogs), and it must not be too corrupt.

Boring thing, economic growth

Countries that clear these hurdles must then draw up their own plans for unleashing growth. This takes time. Madagascar's government, for example, at first presented a wish-list of all the projects that each cabinet minister wanted in his fief. The MCC told it to think harder, and consult more widely among its own people to find out what they thought was stopping them getting richer. Malagasy peasants told them they wanted two things: property rights and credit.

The land-tenure system in Madagascar, as in most poor countries, is a mess. Few farmers have clear title to "their" land, so they cannot easily sell it or use it as collateral to raise loans to improve their productivity. They tend to use land until it is exhausted and then cut down more of Madagascar's pristine rainforest.

The land registry has a backlog of 200,000 claims, which it processes at the rate of 1,000 a year. All records are on paper, stored in mounds on shelves. Both the office's manual typewriters have broken

“R” keys—the most common first letter of Malagasy surnames. The MCC is funding an effort to modernise and computerise the system.

The agency is also backing reforms aimed at creating a proper banking system. Madagascar currently has few banks, which make most of their profits by lending to the government. They don't lend to small businesses because they don't know how to assess business plans and most small businessmen don't know how to write them. The Malagasy government has drawn up a sensible-sounding list of ways to improve both the supply of credit and the quality of demand for it. The MCC will pay for it.

The *New York Times* has dismissed these efforts as “worthy” but beside the point in a country where many villages lack running water, clinics or schools. Many Malagasy disagree. “These are our main bottlenecks,” says Emma Ralijohn, who co-ordinated Madagascar's application to the MCC. “Other donors never tried to solve these problems,” she adds.

In the long run, the MCC's efforts should complement those of other donors. Applicant countries grumble about the time it takes for plans to be approved, but most expect the pace to accelerate as both parties become more familiar with the process. The MCC expects to sign agreements this year to disburse more than $1 billion.

The biggest worry is that the agency does not have enough natural supporters in America. The lobby for foreign aid is dominated by the kind of people who assume that any idea Mr Bush backs must be evil. Mr Bush's party, meanwhile, includes a lot of people who assume that all aid is a subsidy for tyrants' tarts' tiaras. The MCC's next helmsman will have to navigate stormy waters.

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America and Vietnam

One chapter ends...

Jun 23rd 2005
From The Economist print edition

The next is not so clear

DEALING with Vietnam has always caused Americans problems. The war that left about 60,000 American troops and up to 5m Vietnamese dead still haunts a generation of politicians, from John McCain, who famously fought, to Bill Clinton and George Bush, who famously didn't. When Mr Clinton normalised relations with Vietnam in 1995, American conservatives howled about him consorting with the communists. This week, when Phan Van Khai became the first Vietnamese prime minister to visit America in three decades, liberal protesters claimed Mr Bush was ignoring human rights.

America has two reasons for cosying up to Mr Phan. The first is economic. Trade rose from $451m in 1995 to $6.4 billion in 2004, boosted by a bilateral trade agreement signed in 2001. This week, Mr Bush pleased his guest by supporting Vietnam's bid to join the World Trade Organisation. Mr Phan also signed agreements on computer technology with Bill Gates and toured Harvard.

The other reason is military. A new deal hammered out with Donald Rumsfeld, the secretary of defence, goes well beyond the search for American soldiers still missing in Vietnam. Some Vietnamese officers will now attend senior defence colleges in America for training. Defence officials from each side will meet more often and will work to see where they can co-operate on security.

The two countries have a common concern: China. The Vietnamese have not forgotten that, after the American withdrawal, it was the Chinese who invaded their homeland. America, for its part, is increasingly suspicious of China's growing military budget. Having more cordial relations with what one Pentagon official described as a “significant and capable” armed force on China's border could be useful.

Congress seems more uneasy about Vietnam's human-rights record than the administration is. Religious persecution remains a problem in Vietnam and freedom of expression and use of the internet are strictly curtailed. The deal is a boost to Mr Phan's government. Might not those young officers now being trained in America merely use their new skills to hound political dissidents more ruthlessly? The administration, somewhat inevitably, replies that dialogue is the way forward and that Mr Phan assured Mr Bush that progress was being made. Vietnam may be a communist dictatorship, but, economically speaking, it is a long way from Myanmar.

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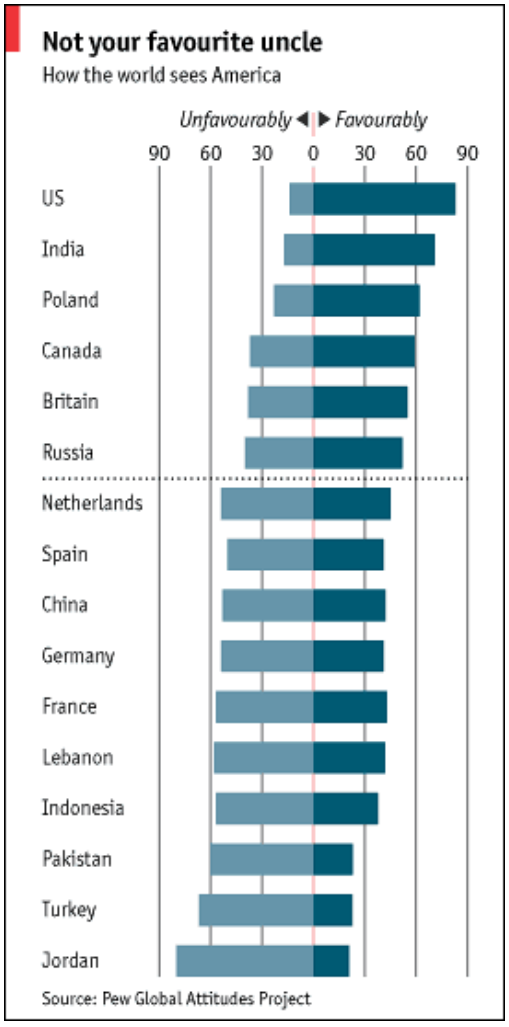
How others see Americans

Still not loved. Now not envied

Jun 23rd 2005 | WASHINGTON, DC
From The Economist print edition

Anti-Americanism is becoming entrenched, and getting more personal



IT IS two years since a surge of anti-American feeling greeted the start of the war in Iraq. In the past few months, the Iraqis have held their election; America has lifted objections to international war-crimes trials over Darfur; Israel's (American-supported) plan to pull out of Gaza has gathered speed; and Condoleezza Rice has been wooing Europeans diplomats with a kinder, gentler foreign policy. Surely, by now the spasm of hostility should be abating a bit.

There are one or two signs of that in a new poll by the Pew Global Attitudes Project, the gold standard of international opinion surveys. Positive impressions of America have risen a few points in France, Germany and Russia since 2004, and have surged in India (since 2002) and Indonesia (2003). Against that, opinions of America are still well below their levels in 2000—and in most places they are still basically negative (see chart).

American officials usually downplay negative opinions as products of policy disputes or personal

animosity, not hostility to the country itself. George Bush remains about as popular as a germ at a medical conference, and public support for the war on terror has slipped markedly in many European countries. This time, though, some American policies are actually popular. People in all 16 countries surveyed said America's relief effort after the Asian tsunami inclined them more favourably towards it (this may explain the sharp improvement in Indonesian opinion). Most countries responded well to President Bush's calls for democracy in the Middle East—though more so in Europe than in the region itself.

So it is all the more sobering to find considerable levels of hostility when people compare America with other countries, or express their views about Americans in general, not Mr Bush in particular. Pew asked its respondents to give favourability ratings to five nations: America, France, Germany, Japan and China. America came bottom of everyone's list everywhere except in India, where it was top, Poland, where it was in the middle and China, where it came above Japan. The British view France and Germany more favourably than they do America. China is more popular than the United States throughout Europe. (Germany won this particular beauty contest, by the way, scoring highly almost everywhere except Germany itself.)

The survey was conducted during the referendum campaigns in France and the Netherlands over the EU constitution. But scepticism about the future of their union does not imply that Europeans want closer transatlantic ties. Half or more in every non-American country surveyed said they wanted Europe to be more independent of the United States, and huge majorities—between 70% and 80%—said they thought the world would be better off if America faced a rival military power.

Americans themselves are still more popular abroad than their country or their president. But the gap has narrowed, partly because the positive image of Americans has declined considerably since 2002. Other people think Americans are hard-working and inventive, yes. But in most countries, more than half think of them as greedy and violent and, in the Middle East, as immoral.

Lands of opportunity

Where would you go to lead a good life?

Destination	Chosen by
Australia	Britain, Canada, Germany Netherlands
Canada	US, France, China
Britain	Poland, Spain
Germany	Turkey, Russia
US	India
China	Pakistan
France	Lebanon
Japan	Indonesia
United Arab Emirates	Jordan

Source: Pew Global Attitudes Project

The Pew poll even raises questions about how far others still see America as the land of opportunity, as Americans do. One question asked: “Suppose a young person who wanted to leave asked you to recommend where to go to lead a good life—what country would you recommend?” Nobody except the Indians picked the United States first (see table).

Given the lack of consistent long-term data, it is hard to know how these attitudes compare with, say, the 1960s. But this is the fifth survey of its kind since 2000. For that period, the Pew polls provide strong evidence that anti-Americanism is more than a blip associated with Mr Bush or Iraq.

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The un-Hillary

Jun 23rd 2005
From The Economist print edition

Put Mark Warner and Joe Biden together—and you have a real alternative

NO BRANCH of politics is less predictable than the presidency. Who would have guessed that Jimmy Carter would have emerged as his party's presidential candidate in 1976? Or Ronald Reagan in 1980? Or Bill Clinton in 1992? That lesson is worth remembering when you contemplate the manoeuvrings for the Democratic nomination in 2008.

There is no doubt that Hillary Clinton enjoys an intimidating lead, thanks to her star power, fund-raising prowess and political tentacles. But there is many a slip 'twixt cup and lip—and Mrs Clinton possesses unique vulnerabilities as well as unique strengths. So it should come as no surprise that the Democrats are already engaged in a slow race to find an alternative.

The most interesting un-Hillary is Mark Warner, the governor of Virginia. During the last presidential campaign, John Kerry once ruminated that “everybody always makes the mistake of looking South”. Some mistake! It may be theoretically possible to win the presidency without making inroads into the South: Al Gore won more votes than George Bush in 2000 without taking a single southern state. But he lost. In practice, it means you have to win virtually every other state. It is no accident that the only two successful Democratic candidates since 1970 have both been southerners. And the same applies to Congress. The Democrats currently have the lowest number of senators since Herbert Hoover was president, largely because they lost five southern seats to the Republicans in the last election.

Which is what makes Mr Warner interesting. It is easy to reduce his victory in Virginia four years ago to slick marketing. The high-tech multimillionaire hired a couple of Democratic consultants, Dave “Mudcat” Saunders and Steve Jarding, who specialise in herding up rural voters. He made peace with the NRA by refusing to back any more restrictions on guns (Virginians are cruelly restrained from buying more than one handgun a month). He sponsored a NASCAR truck and commissioned a blue-grass jingle. He spent a lot of time pressing rural flesh.

But this underestimates both the scale of his challenge and the subtlety of his achievement. Mr Warner was operating in a state so red that it hasn't voted for a Democratic presidential candidate since 1964. A

thoughtful man, he appealed to rural voters without either condescending or pandering. He simply had the decency to take them seriously. He succeeded in winning in rural Virginia without diluting his appeal in the more sophisticated suburbs. And on coming to office he had the courage to raise taxes in order to balance the budget.

The other interesting candidate is Joe Biden. The Delaware senator possesses a unique qualification in the post-September 11th world—a knowledge of foreign policy unrivalled on the Democratic side of Congress. This knowledge is both a shield against Republican attacks and a sword aimed at their heart.

It is a shield because the Republicans love to demonise the Democrats as infants when it comes to foreign policy. The adult-sounding Mr Biden has a long record of hawkishness on both Bosnia and the Middle East to add to his mastery of details. It is a sword because, as the top Democrat on the Foreign Relations Committee, Mr Biden is well placed to criticise the administration. On June 21st, having recently returned from his fifth visit to Iraq, he delivered a coruscating speech to a packed house at the Brookings Institution. He argued that the administration's penchant for happy talk is seriously undermining popular support for the war; he also presented a detailed plan for strengthening America's position in Iraq.

The electable bit

These two potential un-Hillaries have obvious weaknesses. Mr Warner lacks a national profile, though he has made progress in dealing with that, largely by travelling around the country as chairman of the National Governors' Association. He even has the makings of a national strategy—going after both rural voters and disillusioned suburban Republicans. The fact that he has built up a fortune of $200m (without marrying any rich widows) will endear him to the business community; a network of high-tech entrepreneurs might provide the nucleus for his campaign. And the fact that he put so much emphasis on balancing the budget could also appeal to fiscal conservatives. But he has made less progress in dealing with his other big vulnerability—his lack of foreign-policy experience.

Mr Biden's weaknesses are exactly the opposite of Mr Warner's—not too little experience, but too much. Mr Biden has spent more than half his life in the Senate (he was elected when he was 29). His first run for the presidency in 1987 collapsed in ignominy when he was accused of plagiarising his stump speech from—of all people—Neil Kinnock, the dismal leader of Britain's Labour Party. His long voting record gives Republicans plenty to get their teeth into. And his uncommon fluency may come across as senatorial slickness in much of red America.

If Messrs Warner and Biden were rolled into one, they would make a formidable rival to Hillary even at the top of her game. Since that, alas, is impossible, they will have to wait for her to stumble. But the arrival of these two good candidates suggests something interesting about the state of their party.

The Democrats seem to be going out of their way to make themselves look ridiculous at the moment: comparing Guantánamo to the Soviet gulag (Dick Durbin), running make-believe impeachment hearings for George Bush (John Conyers) and howling about white Christians (Howard Dean). But Messrs Warner and Biden both come from the same part of the Democratic Party that Mrs Clinton is trying to make her home: the “sensible centre”. The Democratic left may have the rhetorical energy at the moment. But, thankfully, the real battle for the future of the Democratic Party is in the electable bit.

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Economist.com PRINT EDITION THE AMERICAS

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Brazil's bribery scandal

Jeffersonian democracy, tropical style

Jun 23rd 2005 | SÃO PAULO
From The Economist print edition

AP

True or not, bribery allegations made by Roberto Jefferson (pictured above testifying in Congress) have left Lula's government reeling

LITTLE has been proven. Nearly everything has been denied. Yet a mushrooming bribery scandal that began with a thousand-dollar pay-off to a post-office official has knocked the stuffing out of the government of Luiz Inácio Lula da Silva, Latin America's leading left-wing president. On June 16th José Dirceu, the architect of the victory of the Workers' Party (PT) in the 2002 election, resigned as the president's chief of staff. His exit leaves the government adrift, the ruling party up in arms and Lula suddenly unsure of winning a second term in October 2006.

No one knows yet how deep the rot goes. In eight hours of testimony before a congressional ethics panel on June 14th Roberto Jefferson, then president of the Brazilian Labour Party (PTB), a catch-all grouping, spewed out allegations against Mr Dirceu, top officials of the PT and two allied parties in a sweeping indictment of the conduct of Brazilian politics.

The most sensational charge is that the PT, which lacks a majority in Congress, paid a monthly allowance of 30,000 *reais* ($12,500) to congressmen from two allied parties in return for their votes. Among the beneficiaries, Mr Jefferson charged, were two of the inquisitors facing him on the ethics panel. The PTB refused the allowance, but accepted a campaign contribution of 4m *reais* from the PT "in two huge suitcases". "Everyone knows where the money comes from," declared Mr Jefferson, an amateur baritone, in an operatic performance: companies that do business with state-owned firms (whose bosses are handpicked by politicians).

Even if the charges are false, there are so many that it could take months to discredit them. The opposition, which until a month ago saw no chance of beating Lula in the next election, has every incentive to sustain the agony through lengthy congressional investigations. Until then, the government will be in "permanent crisis", says Walder de Góes, a political consultant in Brasília.

Mr Dirceu's resignation as Lula's top administrator is not itself a disaster. He was lamed politically in February 2004 by a bribery scandal involving one his aides. His return to his congressional seat shifts the focus of inquiry away from the president's office. Mr Dirceu had been a critic of high interest rates and tight budgets, which the government has used to keep the economy on course. His removal strengthens the main champion of that policy, Antonio Palocci, the finance minister . "The government

had two prime ministers," says Jairo Nicolau, a political scientist at IUPERJ, a research institute in Rio de Janeiro. "Now one is left." Dilma Rousseff, Mr Dirceu's successor, was the energy minister; she is a competent manager but not a political heavyweight.

In theory, that should make for more coherent government. Officials talk of stepping up fiscal discipline by eliminating the budget deficit within five or six years and by scaling back earmarking, which dictates how nine-tenths of the budget will be spent. That would encourage lower interest rates and perhaps allow for higher public investment.

The scandal may also prompt Lula to cede more space in government to allied parties, especially the centrist Brazilian Democracy Movement Party (PMDB). At present, the PT holds half of the ministries. Handing some over would be a better way of drumming up congressional support than paying cash. But the president has sent mixed signals about whether he plans a broad cabinet reshuffle, and it is not clear how eager the PMDB will be for a larger share of a troubled government.

Soothing tension within the coalition risks widening the rift between the government and the PT. The party's left wing has never reconciled itself to Lula's austere economic policies or to alliances with pork-barrel parties of the centre-right, such as the PTB. Weakening economic growth and, now, scandal look like vindication. An internal party election is due in September. Several left-wing factions plan to challenge the party's president, José Genoino—one of those named by Mr Jefferson. His defeat, unthinkable until recently, could transform Lula's own party into his government's most corrosive critic.

Belatedly, the government is contemplating reforms that would discourage corruption. It had already tried to deter spending schemes (known as "parliamentary amendments") custom-made for individual congressmen, which often get funding only when the government needs votes. This proposal was blocked by a congressional committee. Officials now talk of trimming the vast number (19,000) of federal jobs held by political appointees. Political-reform schemes, which include public financing of elections and measures to discourage serial party-swapping by congressmen, are back on the agenda. But these bruise too many interests to get through a Congress racked by scandal.

If Lula really wanted to clean up the state he would slim it. Privatisation would put jobs at state banks, insurers and electricity-generation companies out of politicians' reach. But Lula and the PT did not wait nearly a quarter of a century for office to preside over a smaller government with less discretionary power. Their good intentions, they assumed, would be reform enough. That suited traditional politicians, who continued to exploit a bloated state for their own purposes. The flaws in this approach may now be dawning on Lula. Too late, perhaps.

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Cuba's economy

Unappetising

Jun 23rd 2005 | HAVANA
From The Economist print edition

The return of the state sandwich

FOR a decade or so, scores of privately run stalls have peddled sandwiches, pizzas, sweets, milkshakes and the like outside hospitals, universities and other busy spots in Havana, Cuba's capital. They provided tasty snacks with a smile. This month, Fidel Castro's Communist government closed the stalls down, saying a state body will offer a snack service instead. Customers now expect unappetising bites, served with a scowl. Even regime loyalists grumble about the change.

The stalls were among 2,000 small businesses shut down. This is the latest step in a determined campaign by Cuba's president to roll back the timid economic reforms he felt obliged to allow in the early 1990s after the Soviet Union, the island's partner and patron, collapsed. In response, Mr Castro opened the door to foreign investment and allowed Cubans to set up on their own account. Now his regime has been boosted by new alliances. Hugo Chávez, Venezuela's president, provides cheap oil, and China soft loans. Earlier this year, Mr Castro formally declared the post-Soviet economic crisis over.

Officials say that the drive against the vendors is to ensure that the tiny private sector respects the law. But for years, the rows of stalls were tolerated, although prepared food can only be sold legally from home. That is one of many legal intricacies designed to hamstring private business now being invoked. Cubans selling handcrafts to tourists have been told to stop if the materials are not available in state-run shops, where all supplies are supposed to be purchased. Last year the government announced it would issue no new licences in 40 of some 170 categories of authorised small businesses. At their peak in the 1990s, there were 240,000 licensed entrepreneurs, running home-based restaurants and cafés or working as handymen and beauticians. Their number has now dropped below 140,000.

Small and medium-sized foreign businesses are faring little better than the locals. More than half of the 800 foreign companies registered in 2002 have departed, along with 400 firms in free-trade zones. Of 700 joint ventures, fewer than 300 remain. Most involve large firms in tourism, energy, cigars, rum, telecoms, mining and biotechnology—all businesses seen by the government as “strategic”.

Most of the foreigners who leave do so quietly. An exception was Peñasanta, a Spanish dairy firm which had an $8.5m joint venture in Cuba. A manager declared that it was impossible to do business on the island, because of the chaotic organisation of the economy. Managers at bigger foreign ventures complain of higher costs because of recent revaluations of the Cuban peso, stepped-up inspections by ministries, and changes to business rules following a decision to deprive state firms of autonomy over trade and finance.

Foreign diplomats in Havana say that the crackdown on business is motivated by the official fear that it had become too successful. Cubans were learning what even China has come to realise: that private initiative is far better than the state at providing goods and services. Even in Mr Chávez's Venezuela, which claims to be building “21st-century socialism”, armies of street vendors have their place. But, not, it seems in the vision of the future held by Cuba's 78-year-old president.

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Colombia

Electioneering begins

Jun 23rd 2005 | BOGOTÁ
From The Economist print edition

A popular president faces a bruising battle for a second term

THE vote is not until next May, and it is not yet certain that he can be a candidate. But Álvaro Uribe, Colombia's stern conservative president, is already campaigning for a second four-year term. Opinion polls suggest that he has a strong chance. Remarkably, after three years running Latin America's most conflict-torn country, Mr Uribe retains the support of two out of three Colombians. Yet re-election remains a hazardous exercise.

The first obstacle is the Constitutional Court. In the next few months, it is due to rule on the validity of a law pushed through by Mr Uribe which changes the constitution to allow a president to seek a second term. Unusually for Latin America, Colombia has a long tradition of distrust of executive power. The court is fiercely independent. But it may find it hard to ignore the strength of public opinion. In a recent poll for *El Tiempo*, Bogotá's leading newspaper, 89% of respondents agreed that "the people have the right to re-elect a president who is doing things well."

The second hurdle Mr Uribe faces is a reinvigorated opposition. Potential candidates are queuing up to take him on. They include Antonio Navarro Wolff, a former guerrilla and experienced senator, who was endorsed this month by the Democratic Pole, a newish left-wing grouping. A succesful former mayor of Bogotá, Antanas Mockus, is standing as an independent. At a convention on June 10-11th the fractious Liberal party, Colombia's largest, managed a precarious unity. It agreed a platform of opposition to Mr Uribe, himself a former Liberal. The Liberals chose as their new head César Gaviria, a former president and secretary-general of the Organisation of American States until last year. Mr Gaviria says—though few believe this—that he will not seek his party's nomination. Among those who are seeking it is Enrique Peñalosa, another succesful former mayor of the capital who was until recently close to Mr Uribe.

Mr Uribe's greatest strength is his "democratic security" policy. He has transformed the mood of the country by taking the battle to the FARC guerrillas, making road travel safer and strengthening the police presence in remote towns. This year, the FARC has hit back with a series of attacks, mainly on remote garrisons. So far, this has not dented Mr Uribe's popularity significantly.

Trickier for the president may be his efforts to persuade the paramilitaries, as Colombia's illegal armies of right-wing vigilantes are called, to disarm. This week the government finally pushed through Congress a law aimed at setting the terms for the demobilisation of the paramilitaries (some 5,000 of a total of 20,000 have already demobilised). Under the law, which could apply to guerrillas in the future, paramilitaries are required to confess their crimes and could face up to eight years' confinement.

Foreign human-rights groups and some Colombians say the law is too lenient. The paramilitaries are responsible for many brutal massacres of civilians and have close links to the drug trade. The law's defenders say that tougher penalties would thwart peace, and by prolonging Colombia's armed conflict, create more victims.

The law may become the object of partisan debate. If it allows the president to demobilise all the paramilitaries by December, as he hopes, that may help his chances. But even if Mr Uribe is allowed to stand, much of Colombia's political establishment now opposes him and a bruising campaign lies ahead.

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Argentina's courts

Justice or politics?

Jun 23rd 2005 | BUENOS AIRES
From The Economist print edition

A decision to re-open the past

IN THE late 1980s Argentina's government pushed through two laws intended to halt prosecutions of military officers for their crimes in a “dirty war” against left-wing guerrillas. A later president, Carlos Menem, amnestied those military commanders who had been jailed. On June 14th, Argentina's Supreme Court ruled by 7-1 that the two laws were unconstitutional. Some 300-500 elderly officers are now likely to face prosecution.

The ruling was hailed by human-rights groups. Many lawyers argue that the court was right. The laws were extracted from a reluctant government by coup threats and barracks rebellions. They violated the Inter-American Convention on Human Rights, to which Argentina is a signatory.

The Argentine junta of 1976-83 was the most vicious of its Latin American peers: it murdered at least 8,900 people, and perhaps 30,000. The vast majority of its victims were not directly involved with the guerrillas. The reopening of the cases is unlikely to provoke serious tension with the much-shrunken armed forces. Most of the officers concerned are long-retired. (One notorious general, Guillermo Suárez Mason, died on June 21st.)

The decision pleased Néstor Kirchner, Argentina's president, who has championed the cause of the “dirty war” victims. The government faces a congressional election in October. The justice minister, Horacio Rosatti, has suggested that the court declare Mr Menem's pardons unconstitutional.

That might raise doubts about the court's independence. Since taking office two years ago, Mr Kirchner has selected four of the court's nine members. A fifth has announced his retirement; a sixth was suspended on June 22nd. Packing the court is an Argentine tradition: the departing justices were cronies of Mr Menem. To Mr Kirchner's credit, the new judges are well-qualified and were chosen by a more open process. But a decision to revoke the pardons ahead of a vote in which Mr Menem, a foe of the president, is seeking a Senate seat, would smack of political justice.

Some analysts worry that the court's decision reverses that of its predecessor—a reminder that in Argentine jurisprudence “never” never really means never. A bigger test of the court will be whether it goes against other presidential initiatives. Mr Rosatti has said that the government, which is in dispute with several foreign companies, will appeal to the court against unfavourable rulings at the World Bank's International Centre for the Settlement of Investment Disputes. In that case, Mr Kirchner would doubtless hope that the justices pay less heed to Argentina's bilateral investment treaties than they did to its human-rights pacts.

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Chile

Glaciers v gold

Jun 23rd 2005 | SANTIAGO
From The Economist print edition

Public opinion drives a shift in environmental policy

Get article background

Reuters

Down the effluent-rich swanee

LIKE many Latin American countries, Chile has recently begun to care more about the environment. A newish law requires promoters of big investment projects to submit environmental-impact studies. But it is ministers, rather than the government's National Commission for the Environment, who have the final say on whether projects should go ahead. That is starting to worry Chileans—and it is causing problems for companies who thought that government approval was enough.

The most controversial case concerns a $700m wood-pulp plant opened last year near Valdivia, in southern Chile, by Arauco, a subsidiary of the Angelini group, a big family-run conglomerate. In January, it was halted for a month by the commission. Now it has shut down indefinitely, after public protests and media pressure led environmental officials to tighten its operating permit.

The plant is bigger than authorised, and it was built beside a protected wetland into which it pumps its effluent. “It's like putting a lavatory in your living room,” says Fernando Dougnac, an environmental lawyer. Protests flared last year when some of the wetland's black-necked swans, a relatively rare species, started to die and others flew away. The firm denies any responsibility for this. But two independent reports found that the effluent probably killed off weeds on which the swans feed.

A second case concerns Pascua-Lama, a $1.4 billion open-pit gold mine promoted by Barrick Gold, a Canadian firm. It would sit astride the Andean watershed between Chile and Argentina. In 2001, Barrick obtained an environmental permit, but shelved the project because the gold price was low. In December, it resubmitted an environmental-impact study for the (slightly-modified) project. It has yet to gain approval. “Getting a permit in Chile now is probably more difficult than in Quebec and Ontario,” says John McDonough, Barrick's boss for Chile and Argentina.

Farmers worry that the Pascua-Lama project will raise the acidity of rivers whose waters irrigate export crops of grapes. Greens oppose Barrick's plan to remove part of three small glaciers. Environmental officials have asked Barrick to put part of the mine underground to protect the glaciers. As with the Valdivia plant, the outcome is uncertain.

What is clear is that public opinion is starting to drive environmental policy. Under the 1973-90 dictatorship of General Augusto Pinochet, business groups always got their own way. Now, a democratic Chile is searching for a new balance between development and the environment.

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Israel and Palestine

There you don't go again

Jun 23rd 2005 | JERUSALEM
From The Economist print edition

A tense summit between the Israeli and Palestinian leaders demonstrated how politics can get in the way of common sense and co-operation

IT WAS a bad day all round. After their first summit in four months on June 21st, Ariel Sharon and Mahmoud Abbas (Abu Mazen) cancelled a planned joint press conference. The Israeli and Palestinian leaders had agreed on virtually nothing over how to co-ordinate Israel's evacuation of its Gaza settlements in August and what will happen to Gaza next. Their standard positions—Israel accusing the Palestinian Authority (PA) of doing too little to stop terrorist attacks, the PA complaining that Israel was undermining it by making too few concessions to ease Palestinians' lives under occupation—seemed to become even more entrenched.

That was a surprise, for it followed some encouraging meetings between Shaul Mofaz, Israel's defence minister, and Muhammad Dahlan, the PA civil-affairs minister, with some prodding from James Wolfensohn, the former World Bank president who has been sent to help the two sides negotiate. Sources familiar with the talks say they had made a lot of progress on issues that will be decisive for Gaza's well-being after the disengagement.

These include the security regime for goods lorries (the PA wanted them to be able to drive straight from Gaza to the West Bank, with security checks, while Israel insisted on having goods unloaded and reloaded on to different trucks at each border), an airport and a protected Gaza-West Bank road link. A Gaza seaport got the nod from Israel—this week the PA announced preparations for a tender for building it. There was also a deal, which Mr Sharon and Mr Abbas did approve, on demolishing the Israeli houses in Gaza and carting away the rubble—with Israel paying for the former and foreign donors for the latter.

So the gloomy summit may reflect the political pressures that both leaders are feeling, Mr Sharon especially. The Palestinians' Islamic Jihad has launched a series of recent attacks on Israelis, some lethal, in defiance of a ceasefire that the PA brokered in February. As one of the smaller factions, it has the least to lose politically from disrupting the calm. An Israeli official says Israeli forces have prevented several more attacks during the ceasefire, among them a car-bombing with half a tonne of explosive. The ceasefire, complains Israel, is only partly effective, yet Mr Abbas, fearful of a popular backlash, will not order his still-ragged security forces to disarm militants. And if he does not, Mr Sharon said this week, Israel will do it for him. Suiting deed to word, it arrested over 50 Jihad militants just before the summit.

For their part, Palestinians retort that their forces are not even allowed to operate in most of the West Bank; Israel has handed over security responsibilities in just two towns, though Mr Sharon promised this week to hand over two more soon. Meanwhile the rate of Palestinian deaths at the hands of soldiers has dropped by about 80% since February, and Israel is slowly but steadily increasing the number of work permits for Palestinians and has removed some 30 of the hundreds of roadblocks in the West Bank. But children continue periodically to be shot and life continues to be oppressively restricted, which alongside Israel's fervent settlement-building (see article) gives ordinary Palestinians the feeling that little has changed.

The deadlock is not as bad as it seems, though. With the summit over, say the sources, the talks on economic co-operation will pick up where they left off. Mr Wolfensohn, who has already visited twice, is due back in July to knock heads together some more. Security is clearly a more spiky issue, but it too is getting its own pushes from outside. General William Ward, George Bush's security envoy to the PA, is advising on reform of its security services; Egypt, which has an interest in a peaceful Gaza on its doorstep, has sent a small contingent of advisers too; and Israel and Egypt look close to making a deal on letting Egyptian troops patrol the Philadelphi corridor along the Egypt-Gaza border, which will let Israel pull its own troops out of there.

Keep smiling if you can

But as time goes by, compromise will keep getting harder. “Both sides have their own internal constraints,” says Ehud Olmert, Israel's deputy prime minister. Mr Sharon faces growing opposition from right-wingers (an Israeli election is due by autumn 2006); Mr Abbas from the militants who can count on support from an evermore disillusioned populace; and both from rebels within their own parties. Neither can afford not to put the blame on the other. And once the disengagement is over, as it should be by mid-September, the pressures on both men will increase sharply. Anything that needs agreeing on had better get agreed on soon.

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Palestine

They don't believe Israel will leave

Jun 23rd 2005 | RAS AT-TIRA
From The Economist print edition

Even without making new settlements, Israeli settlers are still digging in

"ISRAEL wants to take over Jordan, Egypt, Syria, Lebanon and Saudi Arabia." Rafik Maraabi is a precise, mild-mannered father of five and mid-level official in the Palestinian Authority, not a wild-eyed ideologue. Yet he seems quite convinced that the expansionist credo he once heard from an extremist settler is also, secretly, state policy.

Standing in his village, Ras at-Tira, one starts to see why. Across a valley to the north-east is a rising pile of concrete blocks. Some 1,400 housing units are to be built on the hill known as Givat Tal, between Ras at-Tira and the Israeli settlement of Alfei Menashe.

Under the "road map" peace plan, Israel was supposed to halt all settlement construction in the occupied territories. Officially, it commits to no new settlements, no land confiscation for them, and no building in existing settlements "beyond the existing construction line".

Givat Tal, which began sprouting at the end of last year, shows how elastic that promise is. Though it is within Alfei Menashe's municipal boundary (most settlements have staked out wide claims), another valley clearly separates it from the main town. Moreover, Israel's West Bank barrier, ostensibly meant to keep out terrorists, passes just to the south of Ras at-Tira, cutting it off from neighbouring villages and much of its farmland. The villagers have heard of plans (denied by the army) to declare a 500-metre-wide no-go "security zone" alongside the fence. Not much? In the compressed geography of the conflict, that would swallow up Ras at-Tira and almost everything else between the fence and Givat Tal.

It has been done elsewhere, and is one way to take land without actually confiscating it for a settlement. Another is an Ottoman-era law that still holds in the territories, by which land untended for three years becomes state property. Many, such as Mr Maraabi, do not till their land as the special permits for getting to it through the fence are often refused, opening times are short, and taking a vehicle requires another permit.

Peace Now, an Israeli lobby, says that 3,000-3,500 flats and houses are now being built in the West Bank—enough for twice as many settlers as those due to be removed from Gaza this summer—with thousands more planned. Most are in the main settlement blocks between the barrier and the pre-1967 border (some 7% of the West Bank's area under the barrier's current route), so may end up as part of Israel in a final peace deal anyway. The housing boom will just cement Israel's grip on them more. But that detail is lost on Mr Maraabi and countless other Palestinians: expansionism on their doorstep destroys any belief that Israel will ever allow a Palestinian state.

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Lebanon

Nervous but hopeful

Jun 23rd 2005 | BEIRUT
From The Economist print edition

Lebanon's new parliament, with anti-Syrians on top, looks much better

AFP

Filial Hariri forges ahead

THE elections that ended this week were meant to be the climax of what has been dubbed Lebanon's "cedar revolution". Provoked by the murder in February of Rafik Hariri, a popular former prime minister, the peaceful uprising aimed to sweep a host of ills, from Syrian tutelage to the corruption of Lebanon's own politicians, into the dustbin of history.

The revolution has succeeded—up to a point. Syria's army and agents are gone, as are many of their clients in Lebanese security agencies. Their opponents have just won a crushing parliamentary majority, and promise to use it to push through swift reforms. Yet even as the election posters festooning every wall, lamppost and billboard come down, this divided little country feels eerily the same.

A troika of top leaders looks set to stay in office for the time being: the Maronite Christian president, Emile Lahoud, who was hand-picked by Syria; the Sunni Muslim prime minister, Najib Mikati; and the unctuous Shia speaker of parliament, Nabih Berri, a four-term veteran. Perennial forces also dominate parliament, such as the two Shia parties, Hizbullah and Amal, and the party machines of the Druze warlord, Walid Jumblatt, and of Saad Hariri, the son and political heir to the slain prime minister. The polling itself, especially the crucial last of four weekly rounds, was marred by exuberant vote-buying and mud-slinging, embittered with a nasty undertone of sectarian incitement.

Even the election's biggest surprise came tinged with disappointment. Michel Aoun, a maverick former army general, returned from exile to sweep the polls in the Christian heartlands north of Beirut. His self-declared "tsunami" cheered the many Christians who have felt orphaned since the civil war reduced their traditional dominance of the country. But the 70-year-old Mr Aoun, who poses as an arch enemy of Syria and a vigorous reformer, allied himself with pro-Syrian parties. His uncompromising rhetoric damaged the legitimacy, among Christians, of the delicately multi-confessional opposition coalition led by Messrs Hariri and Jumblatt.

Worse, only hours after the election results were declared, a car-bombing in central Beirut took the life of yet another eminent Lebanese. George Hawi, the gutsy former head of the Communist Party, ran a 3,000-man militia that was aligned with mostly Muslim, pro-Palestinian and Syrian-backed forces during the civil war from 1975-90. In recent years, the 67-year-old Mr Hawi had added his moral weight, as a fiercely non-sectarian Christian and leftist, to the mounting campaign to rid the country of Syria's overweening influence.

The bombing was the ninth to hit Beirut in as many months, and followed the killing in May, by an identical device, of Samir Qassir, a prominent columnist and critic of Syria. The message seemed to be that more such violence may be in store, with the obscure aim of settling old scores, or perhaps simply of keeping the Lebanese pot boiling. That would be bad enough. More worrying still is the fact that not a single culprit has been caught so far.

In the right direction

Yet despite the current anguish and recrimination, Lebanon has come a long way in a short time. Suspicions of continued malingering aside, Syrian influence has been vastly reduced. Mr Hariri and his

allies have won 72 of parliament's 128 seats, the strongest majority in the history of Lebanon's fractious politics. Though Mr Aoun rejects “dialogue with the corrupt”, as he terms his opponents, the fact is that his 14-man parliamentary block agrees with the majority over many issues, including tackling the system of sectarian representation that is widely viewed as archaic and unfair. Even Hizbullah, which also has 14 seats, strongly supports administrative, social and economic reforms. And the push for change has another important constituency: international donors, whose promised aid and relief of Lebanon's national debt of $35 billion depends on the government's transparency and performance.

Meanwhile President Lahoud, who in the past has blocked reformist moves, is much weakened. His tenure now hinges on the blessing of other actors, such as Cardinal Nasrullah Sfeir, who as head of the Maronite church wields much influence over the presidency, an office that by tradition is held by a Maronite. A UN team charged with investigating Mr Hariri's murder has fired a further shot across Mr Lahoud's bow by summoning one of his close aides, Mustafa Hamdan, for questioning. In charge of the presidential guard, he is the only head of Lebanon's six security agencies to have kept his post. Beirut's rumour mill has frequently implicated him in political intrigue.

Mr Berri, likely to be returned as parliament's speaker, is an agile political animal, well capable of accommodating demands for reform. Mr Mikati may also be back as prime minister, since the 35-year-old Mr Hariri is a political novice, and in his brief tenure since March Mr Mikati impressed with his steady determination to tackle corruption and run decent elections.

Most important, Lebanon's people remain wary and vigilant. With the press, civil society and business groups now unshackled, any new government will face scouring scrutiny. That indeed would be one of the best guarantees of freedom.

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Iran's presidential election

Pragmatic v religious conservatives

Jun 23rd 2005
From The Economist print edition

Amid cries of foul, two tough nuts fight it out

Narrow down your choice
Iran's presidential election results, % of total vote

Akbar Hashemi Rafsanjani, former president, pragmatic conservative	*21.0*
Mahmoud Ahmadinejad, ultra-conservative and religious mayor of Tehran	*19.5*
Mehdi Karrubi, mildly reformist former speaker of parliament	*17.3*
Muhammad Ghalibaf, former police chief	*13.9*
Mostafa Moin, former minister, liberal reformer, democrats' big hope	*13.8*
Ali Larijani, former state TV and radio boss, flexible conservative	*5.9*
Mohsen Mehralizadeh, former vice-president, pledged good management	*4.4*

Sources: Reuters; *The Economist*

WHOEVER turns out to have won a two-man run-off on June 24th, Iranians will remember this month's presidential election as much for alleged irregularities in the first round of voting as they will for the eventual result. Early returns after the polls closed on June 17th suggested that Mehdi Karrubi, a reform-minded cleric, would join the front runner, Akbar Hashemi Rafsanjani, in the run-off. Then, as the final results came in, Mahmoud Ahmadinejad, Tehran's conservative mayor, overtook Mr Karrubi, taking second spot.

Mr Karrubi cried foul, drawing attention to Mr Ahmadinejad's success in provinces where the Tehran mayor is little known; in Isfahan, for example, he alleges that ballot boxes were stuffed. Mr Karrubi also accused a national militia, answerable to the supposedly apolitical supreme leader, Ayatollah Ali Khamenei, of illegally campaigning for "one of the candidates". Most damaging of all, Mr Karrubi alleged that Mr Khamenei's son interfered in the election—again, it is thought, in Mr Ahmadinejad's favour. Victory for the mayor, Mr Karrubi asserted bleakly, could usher in "an Iranian Taliban".

Mr Karrubi has not been alone in voicing suspicions. Mr Rafsanjani, a former president who presents himself as a moderniser, has referred to "organised interference". Mostafa Moin, a reformist who performed worse than expected, sounded a "warning bell for our fledgling democracy". Some far-flung provinces did turn in some decidedly fishy results. In South Khorasan, home to many disgruntled Sunnis, the official turnout was an improbable 95%; yet Mr Ahmadinejad, the candidate most associated with intrusive Shia Islamism, won more than a third of the votes.

Some officials are using the high official turnout, 63%, to counter American taunts that Iran is not a proper democracy. Mr Ahmadinejad's healthy share cannot be attributed entirely to irregularities; the mayor attracted conservative Iranians with his personal honesty and reassuringly insular vision. In fact, five out of the seven candidates won at least 4m votes apiece: pluralism of a kind.

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Iraq

A foreign tide that ebbs and flows

Jun 23rd 2005
From The Economist print edition

Europe is supplying fighters for Iraq's insurgency. Will they go lethally home?

IN SPAIN and Germany last week, 14 Muslim men were arrested on suspicion of raising funds and volunteers for the insurgency in Iraq. On June 21st British police joined in, arresting a man in the former Manchester abode of a Moroccan-born Frenchman believed to have blown himself up in Iraq around the time of the election in January. That western Europe should be supplying martyrs for the *jihad* is not surprising: from among its estimated 12m Muslims emerged at least hundreds of Islamist fighters in Bosnia, Chechnya and Afghanistan. And yet the arrests raise a worrying question: will Iraq's foreign fighters return home equipped with deadly new skills of mass murder?

There is a little evidence, and much speculation, that this process has already begun. Compared with the tens of thousands of foreign *jihadis* who fought the Russians in Afghanistan, then trained in al-Qaeda's camps there, the number of foreign fighters in Iraq is small, perhaps in the low thousands. Most are from Iraq's neighbours: Saudi Arabia, Kuwait, Jordan and Syria. Moreover, the insurgents' death rate is high: around 160 have detonated themselves in the past two months; hundreds more have been killed by American troops. Yet European agencies say a handful of Europe-based insurgents have returned home to recruit. Certainly, Europe-based extremists previously focused on other targets now focus on Iraq.

The recent arrests back that claim. The 11 men arrested in Spain were believed to have links to Abu Musab al-Zarqawi, a ruthless Jordanian *jihadi* operating in Iraq; also arrested were five men suspected of involvement in last year's Madrid train bombings. The two groups were linked by a suspected train bomber, Muhammad Afalah, believed to have blown himself up in Iraq last month. The three arrested in Germany were also linked to Mr Zarqawi.

He would certainly not wish to see all his followers consumed in Iraq. “For Zarqawi, the road to Amman, Tel Aviv, perhaps Riyadh, and even Europe, leads through Baghdad,” says Bruce Hoffman of the Rand Corporation. In a report leaked to the *New York Times* this week, America's CIA has outlined the possible results of that journey: a new generation of Islamic terrorists, experienced in urban warfare, kidnapping and explosives, far deadlier than those who emerged in the 1990s from the camps on Afghanistan's plains.

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Sierra Leone

Still in intensive care

Jun 23rd 2005 | FREETOWN
From The Economist print edition

Despite British and UN help, Sierra Leone remains too fragile to go it alone

JUST four months ago Emmerson Bockarie was an unknown undergraduate in Sierra Leone. Then, in February, the musician released an album called “Bor Bor Belleh” (Fat Belly Boys), a reference to the corrupt officials popularly held to be hampering the country's development. The song caught Sierra Leoneans' imagination fast, and the album became a best-seller. From the outset, the singer-songwriter says he knew he had a hit. “It was what people were talking about, but didn't have the nerve to say openly.”

Public cynicism about the inability of the country's leaders to rebuild this failed state is reflected in the virtual certainty that next week the UN will extend its mandate for a fifth time. Instead of going home on June 30th, as originally scheduled, a reduced force (currently 3,000-strong) will stay on at least until the end of the year. This is at the request of the British, who have been leading international efforts to rebuild the country since it emerged from a bloody ten-year civil war in 2002.

The government is keen for the UN peacekeepers to go, on the grounds that while they remain the country is viewed as unstable and investors shy away. Some businessmen, such as Wilfred Sam-King, one of the country's most prominent, agree. “Their presence creates an element of doubt over whether it is safe to invest,” he says. “Their early departure will push international investment forward.”

That seems unlikely to happen as long as corruption continues to flourish, and in that respect Sierra Leone this month received a double blow. First, a meeting between prospective donors in Paris to discuss the World Bank's poverty-reduction strategy was called off, and then the country was left off the G8's list of 18 nations marked down as the first beneficiaries of its debt-cancellation plan. In both cases Sierra Leone's government failed to convince donor and creditor countries that it is truly tackling corruption. Recently it failed to prosecute a minister investigated by the country's anti-corruption commission—and briefly arrested a leading journalist for speculating in print on whether the president was protecting his minister.

Though roads in the capital, Freetown, have got a bit better, some of the basic infrastructure needed to attract investors is still dire. There is a serious water shortage in Freetown and at night the city hums with generators to brighten the blackouts. Too few young people can find jobs. Carew, aged 25, says that, since the war ended, the main difference he sees is more cars and cellphones for the wealthy.

Another worry is the army. Once the UN troops go, the revamped British-trained Sierra Leone army, which includes former combatants from all sides in the war, will run security. Many doubt it will be up to the job. But it needs to be. The last slice of territory still under UN control was handed over to the army only at the end of last year. Elections are due in October in next-door Liberia, where the regional conflict began in the 1980s. Renewed violence there could spill over into Sierra Leone; so could unrest in neighbouring Guinea. Liberia's former president, Charles Taylor, now in exile in Nigeria but thought to be meddling in Liberia's upcoming election, is still wanted by an international war-crimes tribunal sitting in Sierra Leone.

So it is arguable that the UN peacekeepers should stay at least until Sierra Leone's next general election, in 2007, when President Ahmed Tejan Kabbah is due to step down. Among those who think the UN forces should stay is Zainab Bangura, once a presidential candidate, who runs the National Accountability Group, an anti-corruption lobby. “This is our first chance for a free and fair election because there is no incumbent,” she says. “Seeing in a new government would complete the circle.”

There has been some good news, however. The Sierra Rutile mines, which in the 1990s provided the government with $10m a year, one of its biggest lumps of revenue apart from aid, have reopened. And

Partnership Africa Canada, a lobby that tries to stop diamonds fuelling wars, says that cash from the gems doubled last year, though it doubts whether ordinary citizens have benefited yet.

The trickiest period will be the months after the UN troops' withdrawal and before the elections. President Kabbah, who promised “food for all” by 2007, has only a few months to persuade donor countries that his government is sincerely trying to be clean and that the country therefore deserves debt relief and more aid. He may yet find inspiration in the words of another song currently popular on the streets: “Opotho, yema di” (White man, I want to eat).

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South Africa

Is she the next president?

Jun 23rd 2005 | JOHANNESBURG
From The Economist print edition

Phumzile Mlambo-Ngcuka is climbing up the ladder

Get article background

Reuters

Humble, but shrewd

IN THE wake of last week's sacking of the vice-president, Jacob Zuma, after he had been linked to a corruption scandal, President Thabo Mbeki has picked his minister for minerals and energy, Phumzile Mlambo-Ngcuka, to replace him. But the choice may raise a few eyebrows. There have been questions about payments made by Imvume, an energy company implicated in a scandal over campaign funding for the ruling African National Congress (ANC), to a company headed by Mrs Mlambo-Ngcuka's brother; Imvume says this was a legitimate business transaction. Ironically, it was her husband, a former chief prosecutor, who started the investigations that led to the downfall of Mr Zuma, who is about to be charged with corruption himself.

Mr Mbeki has hailed Mrs Mlambo-Ngcuka's appointment as “an opportunity to further strengthen the participation of women in the executive”. She already sits on the ANC's top bodies, including the national executive committee. She is close to the president and promotes his liberal economics. As minister for minerals, she has been instrumental in devising the first charter for “black economic empowerment”, South Africa's version of affirmative action. She is popular among professional and business-minded ANC members. But leaders of the Congress of South Africa Trade Unions, an ally of the ANC which backed Mr Zuma, publicly praise her too, describing her as “humble”, “consultative” and with a “soft spot for workers”.

Could she succeed Mr Mbeki? The president is chosen by members of parliament, not the people. So, in effect, the job is in the gift of the ANC, which dominates parliament. Much can happen before the presidential election, due in 2009. But she may become a strong contender—and if chosen would probably continue to apply Mr Mbeki's broadly liberal economics.

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China's land disputes

Turning ploughshares into staves

Jun 23rd 2005 | BEIJING
From The Economist print edition

Reuters

Ambiguous property rights make it easy to dispossess peasants

A BLOODY clash this month between peasants and hundreds of armed thugs sent by developers to seize their land has thrown a harsh light on one of the most controversial questions posed by China's economic development. Who owns the farmland, and what rights do peasants have if it is requisitioned?

Tens of thousands of disputes arise in China every year over the appropriation of farmland, many of them violent. Yet a fracas on June 11th in the village of Shengyou in Hebei Province, about 200km (125 miles) south of Beijing, has aroused unusual attention in the official media. A video smuggled out by one of the villagers shows his fellow residents being beaten with staves and shovels by a mob of 300 or so helmeted young men. Shotguns fired by some of the thugs can be heard above yells and screams. Six villagers were killed, and around 50 admitted to hospital.

With copies of the video circulating widely on the internet, the authorities responded quickly. The mayor and Communist Party chief of Dingzhou municipality, to which the village belongs, were sacked. The official media reported that 22 people had been arrested, including the bosses of a firm contracted by a local state-owned power plant to build a waste-processing plant on Shengyou's fields.

While land disputes are common in any fast-developing economy, they are aggravated in China by the lack of clarity over property rights. In theory, rural land is “collectively owned”. But it is uncertain whether this means by the villagers themselves or whether township governments, which each control several villages, exercise these collective rights on behalf of the peasants.

Peasants have renewable land-use contracts valid for 30 years, but they cannot sell them. And even if villagers have a theoretical say in the disposal of their land, in practice, villages are usually controlled by Communist Party representatives whose duty is to enforce higher-level orders. Village chiefs elected by the villagers themselves have little power to obstruct them.

The party's refusal to allow private land ownership has eased the takeover of rural land for industrial use, urban expansion or the construction of transport infrastructure. But it has also created vast

opportunities for corruption. Rural officials often pocket much of the money paid by developers as compensation for the land-lorn peasants, or make great profits by taking over land at little or no cost and selling it at market prices. Efforts in recent years to reduce the tax burden on peasants have given local governments even more incentive to sell land to boost their revenue.

Last year, partly fearing that the rapid loss of scarce arable land could affect the country's food security, the government suspended all non-urgent conversion of agricultural land for six months. It then issued regulations requiring any such change to be approved at a high level. China's prime minister, Wen Jiabao, said that failure to curb the requisition of farmland could have “very serious” consequences and lead to growing numbers of landless and jobless peasants.

A pervasive urban fear in China of a deluge of rural poor descending on the cities is exacerbating these concerns. The Chinese media often quote figures saying that as many as 40m peasants have lost their land in the last decade or so. But the threat to social stability suggested by this huge number is less immediate than one might think. Most of the land appropriations take place in the more developed coastal areas, or around big cities. Many displaced peasants in these regions can be smoothly absorbed into the urban workforce.

In these areas close to cities, agriculture has often ceased to be the main source of income for peasants. Many have jobs in local industries, even though they keep their land-use rights. Disputes over compensation for loss of land are frequently driven by peasants' desire to maximise their gains from the transfer, rather than fears over the loss of a vital means of subsistence.

But protests by these relatively affluent villagers can still be an embarrassment to the government. In the village of Maxinzhuang in Shunyi, one of Beijing's rural districts, hundreds of peasants have been protesting for the past month over compensation for the requisition of their land to build a water-sports complex for the Beijing Olympic Games in 2008. “There are no human rights,” muttered one protester, after local police ordered your correspondent to stop interviewing them. Several Chinese journalists have visited the village, but their reports have not been published. The authorities are clearly anxious to avoid tarnishing the image of Beijing's Olympics preparations.

Maxinzhuang's villagers are clearly aware of the high value of their land. Early last year Shunyi's Olympics venue supervisory body agreed to give the village nearly 95m yuan ($11.5m) for its 90 hectares (222 acres) of land, much of which had been used for growing maize and wheat. This is around twice as much per hectare as was offered to Shengyou village. But in both cases, peasants worry that only a small fraction of the cash will trickle down to them through the greedy grasp of corrupt officials.

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Sri Lanka

A glimpse of peace

Jun 23rd 2005 | COLOMBO
From The Economist print edition

A deal on aid may be good for peace, but it is bad for stability

Get article background

THE devastation of Sri Lanka by last December's tsunami left one glimmer of hope: that the calamity might enforce co-operation between the government and the Liberation Tigers of Tamil Eelam, the separatists controlling the north-east of the island. This, in turn, might revive a moribund peace process. Optimism soon faded, as the tsunami in fact seemed to bring renewed war closer. Bloody infighting among the Tigers accompanied bitter wrangling between them and the government over how to share relief supplies. The glimmer is now shining brighter. But hope stems from the collapse of Sri Lanka's ruling coalition, and is tempered by the fear of political instability.

This week Vidar Helgesen, deputy foreign minister of Norway, was in Sri Lanka urging both sides to agree to a “joint mechanism” for distributing international relief in Tiger-controlled areas. They are expected to do so soon.

Three years ago Norway helped negotiate a ceasefire in the 20-year-long war over the Tigers' demand for a separate homeland for Sri Lanka's Tamil minority. But talks on a lasting settlement broke down in 2003. Foreign donors hope that, besides providing a framework for aid distribution, the joint mechanism might eventually help restart peace talks. The financial stakes are high. Sri Lanka has been promised about $3 billion in tsunami relief, on top of $4.5 billion promised in reconstruction help to follow a peace settlement.

The Tigers have wanted such a mechanism ever since the tsunami struck. But the reasons it appealed to them also made it unpalatable to politicians from the Sinhalese majority. They argue that such an arrangement would give the Tigers, who have an appalling record of atrocities, some international recognition; that it would recognise them as the Tamils' sole representatives; and that it would give them a say in the affairs of areas they do not control. Sri Lanka's Muslim minority is especially aggrieved at not having been consulted. Muslim settlements were among the worst hit by the tsunami.

Sri Lanka's president, Chandrika Kumaratunga, has argued that the alternative to the joint mechanism may be war and universal conscription. The government says that, at the local level, where projects are formulated and implemented, the mechanism allows for all groups to be represented. The funds will be channelled through the government and the custodian will be the World Bank. Respected auditors will check the books.

It is true that the Tigers have been threatening a return to war if there is no agreement. But many Sinhalese think the government is being too soft on them. Buddhist monks, very influential in a country where 70% of people are Buddhist, have led demonstrations and starved themselves in protest at the proposal.

The Janatha Vimukthi Peramuna (JVP), a party that mixes Marxism with Sinhalese chauvinism, also flatly opposes any agreement with the Tigers. Since Mrs Kumaratunga's United People's Freedom Alliance relied on the JVP for a parliamentary majority, this seemed to rule out any chance of a deal. But on June 16th, the JVP carried out a threat to quit the coalition if the government did not abandon its pursuit of the joint mechanism.

This has left the path clear to an agreement, but the government in a shaky minority. It will not fall at once—the main parliamentary opposition, the United National Party (UNP), backs the mechanism. But Sri Lanka has little experience of bipartisan co-operation for the greater good. The president seems to be calculating that the JVP is not ready for fresh elections, and will never work with the right-wing UNP.

As ever, prospects for peace rely as much on the intricate politics of the Sinhalese majority as on negotiations with the Tigers.

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India's posh poachers

The buck stops

Jun 23rd 2005 | DELHI
From The Economist print edition

Police hunt an endangered species

IT IS 35 years since India's royalty—an array of some 300 princes, maharajahs and nawabs—lost their privy purses and privileges. But their families are often still treated as local rulers, and many indulge with impunity in their traditional sport of hunting, illegal since 1972. However, Mansur Ali Khan, the Nawab of Pataudi, known as "Tiger" since he killed a creature of that species, spent last weekend in a police cell near his ancestral home, charged with killing a female black buck—an antelope that is one of India's most protected species.

The Times of India

Nob with nag

The former nawab, once a national cricket captain, is also part of the modern Indian royalty—of cricket stars and Bollywood idols. He and his family are serial hunters. His son, Saif Ali Khan, a film star, and an even more famous actor, Salman Khan, were arrested in 1998 for shooting a black buck—the latter star featured in a World Wildlife Fund calendar at the time. The year before, the nawab and his wife, Sharmila Tagore, another film star, were involved in a mass slaughter of birds in Kashmir.

After he was found with the black buck and two hares on June 3rd, the nawab avoided arrest for a fortnight while he worked his political connections to try to make sure he would be let off.

His efforts failed—not surprising at a time when the government is tackling a sharp decline in the population of India's endangered species, including tigers. The killing carries a prison sentence of up to seven years; but such high-society cases rarely, if ever, reach a conclusion, so his main punishment will probably be a battered ego. "He's an icon but, by staying away from the police for two weeks, he turned public opinion," says Vinod Mehta, editor of *Outlook*, a news weekly that ran a cover story last weekend, entitled "The Royal Hunt".

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Indonesia

Bumpy progress

Jun 23rd 2005 | MANADO
From The Economist print edition

Good sense in the local elections

"LOOK at these potholes. What has the governor done about them?" asks a matronly minibus passenger in North Sulawesi province, explaining her decision to vote against the incumbent in the gubernatorial election on June 20th. Another passenger suggests that the man in question, Adolf Sondakh, has been too busy building himself a flashy new house to concern himself with the dreadful state of the province's roads. A mundane local poll, in other words—were it not for the fact that Indonesia has never before allowed its citizens to choose their own mayors, governors and regents (the equivalent of a mayor in rural districts). Direct elections for these posts, which began this month, crown Indonesia's remarkable transition to democracy over the past six years. They might also improve the quality of government across the fissiparous archipelago.

So far, voters have shown the same good sense they displayed in last year's presidential and parliamentary elections. They do not appear to be choosing candidates solely on the basis of religion or ethnicity, as many pundits had feared. In North Sulawesi, which is largely Christian but has a big Muslim minority, many Muslims voted for Christian candidates and vice versa. The winner, Sinyo Sarundajang, is best known for helping reduce sectarian strife in the nearby province of Maluku, during a stint as interim governor. In Kutai Kartenegara, meanwhile, in the Indonesian bit of Borneo, Javanese, Buginese, Banjarese and the local Kutai people all seem to have plumped for the different candidates in similar proportions.

What is more, voters seem to be picking and choosing among the candidates irrespective of party affiliation. In North Sulawesi, another poll found that well over half of those who had voted for the Golkar party in last year's parliamentary election deserted its candidate, Mr Sondakh, in the governor's race. Only two small Muslim parties seem to have maintained any semblance of party discipline.

On the whole, incumbents have been doing well, as has Golkar, which topped last year's parliamentary polls and is thought to have the most efficient party machinery. Indeed, Golkar is aiming to win as many as 60% of the 470-odd jobs on offer around Indonesia. But neither incumbency nor Golkar's backing is a guarantee of victory, as Mr Sondakh's defeat illustrates. Most voters told pollsters that they based their choice on the contenders' honesty and ability. Contact with a candidate's campaign team seems to have counted for more than expensive rallies and advertisements. "Money isn't everything," says Lucky Korah, who took over as acting governor of North Sulawesi when Mr Sondakh stepped down to campaign.

The elections have their flaws, however. For one thing, candidates must be nominated by parties or groups of parties who won at least 15% of the vote in last year's legislative elections, although they need not be party members themselves. That makes it difficult for true independents to run. Three of the five candidates for governor in North Sulawesi were serving or former generals, while the other two were former bureaucrats.

Nor is there much in the way of policy debate. Candidates are required by law to lay out their "mission, vision and programme", but their ideas tend to be anodyne and uniform. In North Sulawesi, for example, all five candidates promised to reduce the cost of education and improve the regional economy.

Voters, meanwhile, might have unrealistic ideas about what their local officials can achieve. Local government accounts for roughly a third of government spending. But it is the national government that sets policy, and local legislators—not executives—who draw up the regional budget. In North Sulawesi, Mr Sarundajang, a member of the Indonesian Democratic Party of Struggle, will have to co-operate with a provincial parliament dominated by Golkar. He will also need to co-ordinate with the province's

regents and mayors. Progress will be bumpy, and not only on Manado's rutted roads.

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Australia

Home at last

Jun 23rd 2005 | SYDNEY
From The Economist print edition

Anti-immigration sentiment yields to humanitarian outrage

Get article background

Reuters

Freedom beckons

AFTER seven years in a detention centre for illegal immigrants, and a short stay in a psychiatric hospital, suffering from depression, Peter Qasim was told on June 20th that he would be free to stay in Australia. He landed illegally on Australia's north coast in 1998, claiming to have fled conflict in Indian-held Kashmir. India will not take him back. Until recently, the answer of Australia's coalition government, led by John Howard, was to lock him up indefinitely. Australia's longest-detained asylum-seeker, he became a symbol of this hardline approach. It has just unravelled.

"Mandatory detention" for illegal immigrants has been a cornerstone of Mr Howard's policies since 2001. In that year he won a third-term election after sending soldiers to turn away 433 mostly Afghan asylum seekers, rescued off Australia by a Norwegian cargo ship. Improbably, change has been forced by a group of rebel parliamentarians in his conservative Liberal Party. They had visited Australia's six immigrant detention-centres and were shocked by what they saw. One of them, Petro Georgiou, threatened to introduce legislation to reform the system. It would have had the support of the opposition Labor Party.

So Mr Howard cobbled together a deal allowing the government to introduce its own law on June 21st, meeting most of the rebels' demands. Families with children will no longer be detained while their cases are heard. Applications for refugee status will be decided within six months. Anyone detained for two years will be assessed by the federal ombudsman—rather than by secretive government officials.

Mr Howard held out on one important demand. He will "streamline" but not drop "temporary protection visas" (TPVs) for refugees. These will still allow the government to deport them to their country of origin at any time. About 11,000 people have qualified for such visas. Mr Howard took the policy from Pauline Hanson, a former member of parliament, in a bid to neutralise her populist, anti-immigrant appeal.

The rebels have captured a changing mood: Australians are questioning the more inhumane aspects of the detention policy. Mick Palmer, a former head of the federal police force, is conducting an inquiry into the Immigration Department after allegations that it wrongfully detained up to 200 people lawfully resident in Australia. His report, due next month, could be explosive.

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Meet the neighbours

Jun 23rd 2005
From The Economist print edition

AP

The European Union has been expanding by leaps and bounds. Robert Cottrell (interviewed here) asks what happens if it stops

"WE MUST not let daylight in upon the magic," said Walter Bagehot, a former editor of this newspaper, contending that the authority of the British crown resided more in the mystique of the institution than in what we might now call hard power. Awe-struck politicians and public opinion in Bagehot's 19th-century Britain behaved as though the monarch was above criticism, the incarnation of wisdom and virtue. But for that to go on working, Bagehot said, the precise mechanics and limitations of the office, and of its incumbents, should remain obscure.

The European Union used to profit from a similar indulgence. It enjoyed a mystique founded on its claim to be a new and more perfect type of political order, capable of guaranteeing a lasting European peace. The complexity of its laws and institutions helped, by blurring popular understanding of what the Union did, and thus allowing both admirers and critics to make exaggerated claims about its powers.

Now the daylight is streaming in on Europe, and the magic has gone. Last year's enlargement of the Union, from 15 to 25 countries, has played a big part in this change, as has the recent constitutional debate. Almost nobody now imagines that all 25 countries are heading for political union in the way that the founding six once talked of doing. It is by no means outlandish, as it would have seemed ten years ago, to suggest that the Union may go the way of the United Nations, or even the Western European Union, to become an organisation with much less political and legal authority, or none at all. This would be manageable for existing members, so long as the single market and the euro continued in business by other means. It would, on the other hand, be seen as a catastrophe by nearby countries counting on Union accession to rescue them from their other neighbours or from themselves. An end to enlargement, of which some EU politicians now talk, would be just as bad.

Keep looking east

This survey looks to the east, where the limits to Europe are most changeable. The question of where to situate those limits has returned in force since the fall of the Berlin Wall. Last year's enlargement fixed the Union's eastern borders at the distant edges of the Baltic states, and of Poland, Slovakia and Hungary. Now, of 15 contiguous countries lying to the east and south-east of those new borders, at least 11 more hope to become EU members, most of them within the next ten years or so, subject to various ifs and buts.

Romania and Bulgaria have already signed their accession treaties and expect to join in 2007 and 2008, though the treaties have yet to be ratified by all EU parliaments. Turkey has a date to start accession talks in October, though that process, if it does begin then, may drag on for a decade or more. Croatia hopes to begin detailed talks once it can persuade the EU that it is co-operating fully with the UN's war-crimes tribunal in The Hague. The other countries of the western Balkans—Albania, Bosnia, Macedonia, Serbia and Montenegro—have been promised EU membership in principle, but without a timetable.

Ukraine wants to join, but may be ten years away from starting talks. Moldova and Georgia would love to follow. At the back of these countries looms Russia. It has no desire to join the Union as an ordinary member, but it fears loss of influence in eastern Europe, and it has long tried to construct a countervailing block of ex-Soviet countries, with itself at the centre.

This survey will look beyond the recent post-constitutional doom and gloom about Europe's future, to argue in favour of continued enlargement of the Union as the best way to manage relations with neighbouring countries, save for Russia. But it will base that argument on the proposition that enlargement is turning the Union into a more loose-knit and pragmatic undertaking into which new members can more easily be fitted—if necessary by denying them some of the rights and privileges which older members enjoy. It presumes that the French-led rejection of the EU constitution, once the dust has settled, will encourage movement towards a looser Union, even if that is not what French voters intended. The French “no” said, in effect, that even France, long the champion of ever closer union, wanted to be less in thrall to the thing it has created.

The history of the Union can almost be written in terms of its struggle to find alternatives to membership which it could offer to keep its neighbours happy but excluded. Each time the Union has failed brilliantly, agreeing to an enlargement and making it work. That is a thought to encourage Turkey, Albania or Ukraine, none of which will be inside the Union for years yet, but none of which can decently be excluded for ever, or while the Union lasts, whatever Europe's current mood.

The EU's latest non-membership strategy for nearby countries, launched two years ago, goes by the name of the “European Neighbourhood Policy”. Under this policy, the Union offers the countries of North Africa, the Mediterranean, the southern Caucasus and eastern Europe graduated access to the single market, plus financial and technical aid, in exchange for reforms bringing them closer to the Union's political and economic models. But these things are presented as a substitute for membership, not as a precursor to it. Countries can aim for a partnership with the Union so close that it brings them “everything but the institutions”, said Romano Prodi in 2002, when he was president of the European

Commission.

That makes the European Neighbourhood Policy something bigger, but not necessarily better, than the "Barcelona Process", a programme the EU launched in 1995 to offer the countries of the southern Mediterranean market access, plus cash and technical aid, in exchange for economic and political reforms, but with no prospect of membership. The EU will have spent almost *euro*9 billion in the region by the end of 2006, with very little to show in return. "The economic performance of the region has stagnated...political reform has also been almost non-existent. Societal trends, for example tendencies in favour of radical Islam, are deeply worrying," according to a recent study by Michael Emerson and Gergana Noutcheva of the Centre for European Policy Studies in Brussels.

The carrot of choice

If the European Neighbourhood Policy offers the countries of eastern Europe and the southern Caucasus much the same incentives that the Barcelona Process offered the countries of the southern Mediterranean, it is in danger of producing much the same results. "So far, it is easier to find reasons for scepticism than optimism" about the European Neighbourhood Policy, say Ben Slay and Susanne Milcher, economists with the United Nations Development Programme in Bratislava. The Union spreads its values most effectively through peer-pressure for change, linked to hopes of accession. Without such hopes, governments lose motivation. Aid, even market access, is no substitute.

This survey therefore recommends reversing the headline aims of the European Neighbourhood Policy, at least where the Union's neighbours to the east are concerned. It suggests offering membership in name to any country that can meet Europe's basic criteria (of functioning democratic institutions, a market economy, and the capacity to implement EU law), but membership with restricted rights. If one decisive objection to Turkish membership, for example, is that Turkey's big population will give it too large a voting weight in the EU's Council of Ministers, then better all round if Turkey is allowed to join the Union but with its voting rights restricted, perhaps giving it no vote on "constitutional" issues, and no veto at all.

This approach would mean that EU membership, certainly for new members, would count for less. But if this survey is right to see a more fragmented Union emerging, with more limited political ambitions, then membership is starting to count for less anyway.

AP

George speaks, Georgia listens

The idea that the Union is needed to stop its founding members from going to war with one another has long faded. Stripped of its early Utopian rhetoric, the Union can be seen as the sum of its functions and nothing more. Some of those functions are good (such as the single market, and the Schengen agreement to open internal borders). Some are bad (such as the common agricultural policy). All are open to debate. It is external security threats, and relative economic stagnation, that worry European countries now, and countries differ about how best to tackle them. Flexibility is needed.

Conventional wisdom in Brussels has come round to the idea that not every country needs to take part in every Union project. This is already being put into practice, but as the exception rather than the rule. Only 12 of the EU's 15 pre-2004 members have joined the euro zone, for example, and only 13 of the 15 have implemented the Schengen convention abolishing internal borders.

This is the trend that used to be called, disparagingly, "Europe à la carte", meaning the freedom for countries to pick and choose between the projects they wanted to join and the commitments they wanted to make within the Union. Once countries were allowed to diverge in some things, the argument went, they would diverge in all things, and the Union would break up altogether.

In some ways, the Union is indeed growing weaker. The supranational institutions are losing ground against nations and governments. Just look at Germany's and France's revolt this year against the stability and growth pact, which was supposed to be a foundation of Europe's monetary union; or at France's overturning of the services directive, which would have doubled the scope of the single market; or at the debacle over the constitution.

But "Europe à la carte" may yet mean a happier and more effective Union, if it means that more things

get done. Not all EU countries want to harmonise their corporate taxes, or share a public prosecutor, or pool their votes in the International Monetary Fund, but that is no reason why sub-groups of them should not agree to do so. Any trade-off between the “widening” and the “deepening” of Europe is proving less simple than advocates of either course have usually claimed. A widening Europe is a more uneven Europe, deep in some places and shallow in others.

What matters externally is that Europe's political and economic values should go on penetrating and changing the countries round about. It may sound arrogant to talk of the Union as offering the only viable model for European states, but so far the alternatives are not encouraging. Ukraine and Georgia have revolted against a post-Soviet model of crony capitalism and rigged democracy. Moldova is half-way to following, and Belarus may do so one day. European liberalism offers Turkey the best hope of preserving its delicate balance between moderate Islamic society and secular state. For the Balkans, Europe appears to be the only possible escape from post-war poverty and isolation.

The main organised challenge to the European model comes from Russia, which covers or dominates the rest of the extended continent. Russia is still in a process of self-discovery, but seems to show a continuing strong bias towards authoritarianism, so far of a mild and partial kind. It is enough to worry most western countries but not yet to repel them. EU countries disagree about how best to manage relations with Russia, because of their different interests and different experiences there. The main common strand in their relations is an imprudent but increasing reliance on Russian energy.

The United States is also deeply interested in the countries to the east of the EU, bringing its own priorities and policies to bear. America has most to fear from an anti-democratic Russia allied with an anti-democratic China. It needs either a strong democratic Russia, or a weak Russia regardless of government. In either case, prising away the countries around Russia's borders, and building friendly democracies there, is a step in the right direction. That is what George Bush has been doing this year—reassuring the Baltics, praising Ukraine, encouraging Georgia's new pro-western government, and inciting the Belarussians to get rid of their dictator, Alexander Lukashenka.

This puts pressure on Europe to take sides. Either it offers these new and future post-Soviet democracies the prospect of membership in some form, which is what they and America would wish. Or it says to them that they do not belong to the West, but to some vague domain between the EU and Russia—where, in effect, Russia could dominate them.

Given the deficiencies of Russia's political and economic institutions, there is a strong case for Europe to reach out more boldly to Ukraine, and Moldova, and Georgia, just as it should to the western Balkans and Turkey. But it is important to recognise the resistance to further enlargement that has grown within the Union countries, and the reasons for it. Further enlargement of the Union in its present form would mean open borders with the Balkans, Chinese-level wages in some labour markets, and Turkey as the greatest power at summits in Brussels. There would be much to be said for each of these things, but not nearly enough to win over public and political opinion.

Ever wider union

The issue for the EU is no longer how to export stability and prosperity to the countries around it. It has learnt how to do that through enlargement. The issue is how to continue enlarging, how to persuade public opinion within the Union that stability and prosperity can be exported without importing instability and poverty in exchange. That is doubly difficult when public scepticism cuts so deep. A majority of voters in France, and perhaps in other countries too, seems to doubt that the Union is a force for stability and prosperity even across its present membership. This is dangerous disenchantment.

To meet the neighbours, and to consider further what continued enlargement, or the lack of it, might mean to them, this survey will begin with those countries that joined the EU last year, and those on the point of joining in a couple of years' time, Bulgaria and Romania. It will then adventure into the wider and wilder Europe beyond, moving through the Balkans and eastern Europe before coming to rest on Turkey's Black Sea shores. It will see Russia as a country set apart from the rest of Europe by history and geography, but it will look to a Russian monarch, Catherine the Great, for the pithiest summary of Europe's place in the world. “I have no way to defend my borders”, she once said, “except to extend them.”

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Transformed

Jun 23rd 2005
From The Economist print edition

EU membership has worked magic in central Europe

BY CULTURE and language, by history and landscape, the countries that joined the European Union last year offered more of a complement than a contrast to the existing membership. Slovakia, the Czech Republic, Hungary and Slovenia were recognisably still the Habsburg cousins of Austria, if a little countrified by separation. Poland and the Balts echoed an older Hanseatic order.

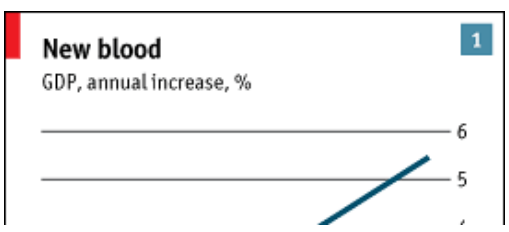
It was only when you asked people what they earned that the real division between the West and the rest became clear. When you crossed the border from Germany into Poland in 2003, average income per head fell by four-fifths, from $27,600 in Germany to $5,400 in Poland. When Romania and Bulgaria join the EU in 2007 or 2008, they will be poorer even than the central Europeans. According to Deutsche Bank, Romania's average income per head in 2005 will be $4,084 and Bulgaria's only $3,735, roughly half Poland's current level.

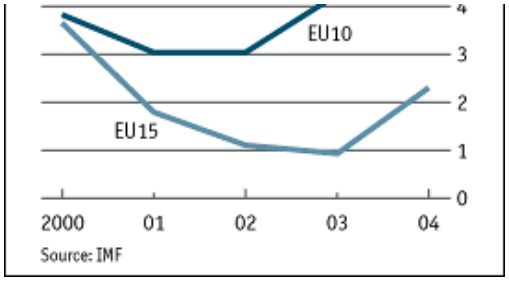
Figures like this help to explain why the EU has lost so much of its enthusiasm for enlargement, despite the relative success of the 2004 round. It has grown panicky about competition for jobs and investment from the countries it has just embraced. It is reluctant to add to that competition by promising to admit even more low-wage countries later. “The Polish border is 1,800km (1,120 miles) from London but 80km from Berlin,” says one German official, asked why Britain has opened its labour market to the eastern newcomers but Germany has not. Germany fears a free flow of Polish workers, and even more of Turkish ones. Turkey's population of almost 70m is about the same as the combined total of all ten countries that joined the EU last year, and it is poorer than any of them. Ukraine, another would-be member, has 47m people, with an income per head of around $1,000 in 2003.

Western Europe's fears are understandable but counterproductive. Low-wage countries next door should be seen more as a resource than a threat: they attract business that would otherwise go to low-wage countries on the other side of the world. But can Europe come to see it that way? The would-be members among the EU's neighbours can only hope so. They have seen their friends and neighbours in central Europe transformed by EU accession. Having failed to catch that first wave of enlargement themselves, they are now praying for a second chance.

The EU's newest members, though much poorer than France or Germany, are already a lot richer than they were immediately after communism's collapse. In 1991, Poland's GDP per head was just $1,998. The EU led the way in central Europe's rehabilitation, helped by America's USAID and other international agencies, giving or lending $18 billion to central Europe in the 1990s. Just as valuable was the work of multinational companies that bought or built operations in central Europe. They set new standards for wages, training, workplace safety and technology transfer, creating a “meritocracy in which hard work, ethical behaviour and a desire to learn” were properly valued locally for the first time in decades, says Charles Paul Lewis, author of a study on these companies' role in post-communist Europe.

But even this intervention brought deep change only because the central Europeans really wanted to anchor their democracies and raise their long-term living standards, even at the cost of short-term disruption. The accession process gave politicians an alibi for unpopular reform. Civil servants spent so much time in Brussels that they felt as accountable to the European institutions as to their governments at home. Voters wanted the West, if not for themselves then for their children.





Soon they will have it. From the viewpoint of the western European countries, the transition in central Europe has worked almost embarrassingly well. By the end of the 1990s, the countries there had reached a level of political and institutional development that made it impossible to refuse them membership of the Union, even though their incomes and wages were still only a small fraction of those in the older member states. Now their economies are continuing to grow at rates shaming the ones that used to be their models (see chart 1). This year even the laggard of central Europe, Hungary, is likely to grow more than twice as fast as the euro zone. The Baltic countries look set to grow at more than four times the euro zone's pace.

Watch them grow

Extrapolate from that, and the implications are startling. Latvian incomes are currently the lowest in the EU, but if the Latvian and the German economies were to go on growing at last year's rates of 8% and 1.6% respectively, then, all other things being equal, Latvian incomes would overtake German ones in 2032—which is to say, within the working lifetime of a young adult. That should be a thrilling thought for Latvians. It should be a thrilling thought for Germans too, since they would then no longer have to worry about low-wage competition. In reality, however, the thought of becoming poorer than a former Soviet republic is likely to make Germans unhappier still.

The fear of workers flooding in from Poland or Estonia has caused all but three countries in western Europe to close their labour markets to the new members for up to seven years. This year France and Germany blocked an EU law opening up national markets to services from anywhere in the Union, for fear that self-employed workers would arrive by this route. This French-led move was inexplicable to anybody from a more consumerist society. French trade lobbies gave warning that Polish plumbers would swamp the country, yet they also agreed that France was desperately short of plumbers. The arrival of Polish plumbers, even by the thousand, could only have been a blessing.

The new members have also upset the old with their taste for flat and often low rates of personal income tax and corporate tax, chosen mainly for ease of collection. Other payroll taxes and indirect taxes mean that the overall tax burden in the new member states is still similar to that in the old. But France, Germany and Belgium have accused the newcomers of unfair tax competition, and called for minimum rates for corporate taxes across the Union. Nicolas Sarkozy, when French finance minister last year, suggested cutting EU budget payments to new members that insisted on setting low tax rates.

Investors, by contrast, love the new members for their low wages, high productivity and simple taxes. Build a factory there, and you get EU market access at far less than average EU costs. According to the Boston Consulting Group, if you want to sell refrigerators or cars in western Europe, it can be cheaper to make them in Poland than in China. A.T. Kearney, another consulting firm, reckons that the acceptance of Ukraine as an EU candidate could quickly triple the recent rate of foreign direct investment there.

But it was not only EU market access, granted progressively to the central European countries through the 1990s, that attracted investors to the region then and continues to attract them today. It was also the expectation that the rule of law and the quality of government would rise towards EU levels as the accession process continued. Firms will build factories in difficult places if they have to, but they much prefer places where contracts can be enforced, property rights are secure, taxes are predictable, executives feel safe, and workers get basic social services from the state. Conditions like that help to mobilise domestic investment too.

In our back yard

If Ukraine and Turkey are brought inside the EU, they will create, together with Romania and Bulgaria, a low-wage industrial powerhouse in Europe's back yard, a zone of 150m people able to compete even with China or India (see table 2). That thought might frighten highly paid workers in Germany or France. But it is better for all of Europe if new investment goes to eastern Europe and not to faraway China or Brazil. More investment and more growth in low-wage Europe generates more demand for goods and services from high-wage Europe. That helped Germany to run a trade surplus with Poland last year, for example.

The EU countries with more to fear from further enlargement should be those in central Europe which are the Union's lowest-cost producers right now. Slovakia has had spectacular success in attracting foreign direct investment, especially from the car industry. Soon it will produce more cars per head of population than any other country in the world. But in five or ten years, says Ivan Miklos, the Slovak finance minister, the country's competitive advantage in mass production will slowly but permanently decline as Romania, Turkey and Ukraine catch up. Slovakia wants to encourage more high-tech and service industries by improving the education system and the business climate.

The Slovaks have it right. Enlargement is globalisation in miniature. If the EU holds its neighbours at bay, it is putting off a shock of adjustment that will get bigger and bigger the longer it is delayed. Germany has 5m unemployed, not so much because old jobs in old industries are vanishing there (though they are) but because an inflexible German labour market deters firms and individuals from creating new jobs in new industries in which German companies are still world-beaters.

All the same, tactically it may be a good idea to accept that free movement of labour is incompatible with further EU enlargement, not for economic reasons but for political ones. If rich countries want to block cheap labour, let them do so. Europe has capital mobility to compensate. If workers cannot come looking for the jobs, the jobs will go looking for the workers. The central Europeans' experience suggests that the more assured Turkey and Ukraine can be of EU membership, the more foreign investment they will get.

If, on the other hand, these countries are kept outside the EU, investors will expect political and economic reform there to be slower and less secure. Investment will be lower, and growth with it. Something of the sort has been visible in Turkey where, despite a customs union with the EU, foreign direct investment has been much lower than in most central European countries relative to the size of the economy—a fifth of the Czech Republic's level and a third of Poland's between 1994 and 2003. Less investment means fewer jobs at home, lower incomes, less trade and more pressure on workers to find jobs elsewhere. Everyone loses.

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Climate change

Jun 23rd 2005
From The Economist print edition

What post-communist countries need to flourish

THE further east you went in the first decade after communism, the more remote the European Union became, and the easier it got for crooks and populists to capture power. In every post-communist country, the rejection and collapse of the old order forced at least some shaky first steps towards democracy and the market economy. But this progress soon faltered if predatory groups of rich and violent people could invade and capture government, rigging privatisations, stealing public money and blocking further reforms that might encourage more competition in business or in politics.

This was the story of “reform” in much of the Balkans, and in much of the Commonwealth of Independent States (the ex-Soviet Union minus the Baltics). Often, the new ruling groups defended themselves by claiming that conditions in the country were not suited to reforms along western lines. The most common feature of laggard countries was a “drift in policymaking and a search for a peculiar national model of development at the level of theorising”, says Laszlo Csaba, a political economist at the Central European University in Budapest.

The inverse of reform in post-communist countries was, for all practical purposes, corruption. The term covers a multitude of sins, but the kind most harmful to a whole country is “state capture”, whereby a group of political and business insiders bribes or bullies its way into control of a ministry or a government agency and then runs it for its private profit. State capture “may establish a hidden political regime at odds with the constitutional purpose of state institutions”, says Rasma Karklins, a political scientist at the University of Illinois. It undermines democracy as well as economic growth. That may be a large part of the reason why democracy and growth have gone hand in hand in the post-communist world.

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Taming the Balkans

Jun 23rd 2005
From The Economist print edition

Could EU accession do the trick?

Robert Harding World Imagery

One day, Croatia's boat may come in

FOR a gruelling decade, the world viewed the Balkans through the prism of the region's most strife-torn country, says Ivan Krastev, a Bulgarian political scientist. In the early 1990s that country was Croatia or Bosnia. By 1999 it was Kosovo, illuminated by the bombing of Belgrade. Two years later attention shifted to Macedonia, brought to the brink of civil war by ethnic tensions between Macedonians and Albanians. These successive crises promoted the image of a whole region in continuing turmoil, even though the worst was over by 1995.

This pessimistic view did at least have one redeeming quality. It allowed outsiders to hope that, when peace was restored across the region, everything else would start to come right. Economic recovery would provide the foundations on which durable and free-standing democracies could be built. But now peace has indeed been restored, and yet the good news more or less ends there. Economic recovery has been patchy, and has not yet led to irreversible and locally rooted political change in most of the region.

The International Commission on the Balkans, a non-governmental body of experts led by Giuliano Amato, a former Italian prime minister, published a report in April that gloomily reflected:

> The region is as close to failure as it is to success. For the moment, the wars are over but the smell of violence still hangs heavy in the air...Economic growth in these territories is low or non-existent; unemployment is high; corruption is pervasive; and the public is pessimistic and distrustful towards its nascent democratic institutions.

The Foreign Investors' Council of Serbia sounded only slightly less bleak when it published its annual White Book on business conditions in March. On paper things might be looking better, it said, but:

> The adoption of laws without implementation and enforcement achieves little...[The] momentum which Serbia's transition process had gathered in earlier years has now dissipated.

There are patches of relative optimism here and there. This year the International Monetary Fund praised as “remarkable” and “commendable” the economic performance of Albania, where real incomes have doubled since 1998. Macedonia's constitutional order has been looking more robust since voters allowed a new law on local government to pass late last year. But by and large, the coming of peace to the Balkans has merely allowed the deep problems of state weakness, and of incomplete state-building

projects, to be seen more clearly.

The “open status” issues of Kosovo and Montenegro obstruct the normalisation of political life in Serbia, the western Balkans' biggest country, and thus overshadow the whole region. International talks on the future of Kosovo, which legally is still part of Serbia, are due to begin later this year and may well lead to eventual independence. The future of Montenegro may be decided by a referendum next year. The choice is between independence on the one hand and the status quo—a loose federation with Serbia—on the other.

Outsiders hoped and assumed a few years ago that peace in the Balkans would free people in the region to concentrate on economic development. Voters would push leaders to worry much more about raising living standards and much less about re-opening quixotic and violent national questions. Why have things not turned out quite that way?

Part of the problem is that, even in times of peace, the power and assets of a weak state are still up for grabs, especially if the state has been federalised and if the constitutional order has not been entrenched beyond any expectation of change. The country will be restless, communities will compete, the rule of law will be fragile, the government will be fractious, private investment will be risky. So it is across the Balkans. Whatever the final constitutional order is going to be for any of these countries, the important thing is that its finality should be obvious to everyone, and universally accepted.

No loose ends

That is one argument for giving independence to Kosovo and Montenegro now. Independence for both would have an air of finality about it which a loose federation or a special jurisdiction never could. Separation would allow those new countries, and Serbia, to concentrate on the quotidian business of economic reconstruction, and of capacity-building in government, without national questions to distract them, and with nobody else to blame for their problems.

Opinion polls show that most communities in the Balkans are ready to accept the sort of order which most western governments would like to see installed there. This would mean independence for Kosovo, probably in stages, severing it from Serbia but denying it union with Albania. It would mean independence for Montenegro. And it would mean making the best of Bosnia as a hybrid state, half run by Serbs and half by Bosniaks and Croats.

Fears that independence for Kosovo might inspire fresh independence struggles among Serbs in Bosnia and Albanians in Macedonia may be exaggerated. Polls show that Bosnia is no longer what the Amato commission calls a “highly contested state”. Most Serbs in Serbia, and almost half the Serbs within Bosnia, do not want to break Bosnia up and join its Serb half with Serbia. Across the region, there is a consensus view that Serbia and Montenegro will probably go their separate ways (even though most Montenegrins currently want to keep the status quo), and that this separation will be a good thing.

Most Macedonians strongly reject the idea of dividing Macedonia into Macedonian and Albanian statelets, and joining the Albanian part of it with Albania itself. Albanians are very slightly in favour of it, but most do not think it will happen. The one possible upset is over the question of joining Albania with an independent Kosovo. Kosovo Albanians are keen on the idea, Albanians in Albania just about in favour, and both think it is more likely to happen than not.

If the commission and its polls are right, therefore, the public mood in the Balkans may be ready for some big steps forward. The acquiescence of the Serbian government in Belgrade will be the key to a peaceful break-up of the country and its approval by the United Nations. If the government in Belgrade objects, then China and Russia will probably take its side in the UN Security Council, blocking progress and perhaps provoking fresh unrest in Kosovo. The question is how to win Serbia over. Probably the only answer is by giving it a faster track towards EU membership.

Nearest and dearest 3

Development aid received per person, 1995-2002

Region	€
Balkans	246
South and east Mediterranean	23
European CIS	9
Central Asian CIS	4

Source: "European Neighbourhood Policy: Strategy or Placebo?" by Michael Emerson, Centre for European Policy Studies, 2004

The next question is whether the EU is ready for that. If that strategic bargain can be struck, then it will become harder to deny the remaining countries of the Balkans a fast track too. Otherwise, what will be left there? A sink of countries seemingly unable to generate the hope and confidence needed to trust their own governments, let alone the neighbouring ones, and obliging the rest of the world to keep them in order and in funds. On a per-head basis, the world has put 25 times as much money and 50 times as many troops into Kosovo as it has put into post-conflict Afghanistan. The aid the EU has given to the Balkans in recent years dwarfs the amounts given to other countries on its borders (see table 3).

Croatia's credentials

The road to EU membership is currently being explored by Croatia, which finished its territorial war and its ethnic cleansing in 1995. The completion of those projects, followed by the death in 1999 of the country's veteran leader, Franjo Tudjman, allowed a line of sorts to be drawn between wartime Croatia and its post-war continuation. Croatia re-cast itself as a more or less liberal democracy where nationalism had been tamed, a country still a little rough round the edges but ready and willing in principle to form part of a peaceful and orderly Europe, a place where "moderate nationalists could provide a soft landing for exhausted or failed nationalist projects", in the words of Jacques Rupnik, a French political scientist.

But Croatia exaggerated the depth of its transformation for foreign consumption, and perhaps ended up believing some of its own publicity. It thought, wrongly, that other European countries were so keen to put the ghosts of the Balkan wars behind them that they would forgive Croatia's failure to co-operate fully with the United Nations war-crimes tribunal in The Hague. The tribunal's most wanted fugitives include Ante Gotovina, a Croat general charged with ethnic cleansing during Croatia's war with the Serbs. Carla del Ponte, the tribunal's chief prosecutor, said the Croats could do much more to help find him; the Croats said they had no idea where he was.

That was enough to derail Croatia's hopes of opening talks with the EU in mid-March. The EU postponed them the day before they were due to start, mainly at the urging of Britain, and over the objections of Austria and Hungary. The right outcome would be a reform of Croatia's intelligence services and special police to sack or demote those responsible for shielding Mr Gotovina. Even if that does not produce the man himself, it would at least show that the elected government had gained full authority over the state security services, which in March was still far from clear.

Croatia can scarcely afford to drag its feet. The job of reforming its public administration and its economy looks like at least five years' hard work. The state controls too much and delivers too little. Public spending accounts for fully half of GDP. Public debt rose from 30% of GDP in 1995 to 55% in 2003. External debt doubled from 41% of GDP in 1997 to 82% in 2003. Key health indicators are far below EU averages. Half the beneficiaries of social assistance are able-bodied but unemployed. Only 60% of adults have had more than eight years of schooling.

Working in Croatia's favour are two main factors. By the standards of EU candidates it is relatively rich, with a GDP per head of $7,700 last year, more than twice the level in Bulgaria or Romania. And it has a beautiful Adriatic coastline, making it a favourite holiday destination for millions of Europeans, a sentimental factor not to be underestimated. It can be hopeful of EU entry by, say, 2010 if only it can solve the Gotovina problem (and, of course, if the EU is still in business then).

But the graduation of Croatia from the badlands of the Balkans to the safe haven of the EU will only increase the sense of isolation and abandonment across its hinterland. The International Commission on the Balkans proposes a general solution that is admirable in its detail and its directness. It says that Kosovo should be launched on a phased transition towards full independence and sovereignty, for the first few years of which the international community would reserve powers over human rights and minorities. Once that was agreed, and Montenegro had decided whether to stay with Serbia or go it alone, the EU should convene a Balkan conference in 2006 and give each country its road map to membership.

Macedonia would be invited to start EU accession talks by the end of that year. Serbia and Montenegro, as one or two countries, would also be invited to start negotiations or, failing that, would be offered a "Europe Agreement" similar to those given to central European countries before they began negotiations. Albania would be offered the same sort of deal, and invited to join NATO. The powers of

the Office of the High Representative in Bosnia would be transferred to the European Commission in Brussels, and vested in an EU accession negotiator there. The hope would be that all these processes could be completed, and the EU enlarged into the Balkans, by 2014. Europe's present mood does not favour that outcome, but it is hard to think of one that might work better.

The solution proposed by the Amato commission mixes practicality with romance, optimism and desperation. Probably all those things are needed in equal measure if the Balkans are ever to be helped to help themselves.

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A bearish outlook

Jun 23rd 2005
From The Economist print edition

The EU's relations with Russia are bad and may get worse

AP

Where Europe leads, will Russia follow?

FOR most of the past 500 years, the idea of “Europe” has served to define a shifting huddle of western countries seeking to distinguish themselves from two great Eurasian powers in the east: the Turks and the Russians. Now both Turkey and Russia think that they should be seen as part of Europe too. And Europe, as represented by the European Union, more or less agrees. The idea is pleasing, but the implications are perplexing.

Turkey wants to become a full member of the Union (for its chances of getting in, see article). Russia does not seriously want to join the Union, mainly because, like America and China, it sees itself as a country too great to accept constraints on its sovereignty. But at the same time Russia hates the thought of being excluded from anything. Ideally, it would like a special relationship giving it visa-free travel in EU countries; generous access to the single market through what it calls the “Common European Economic Space”, a loosely defined agenda of trade and market policies; and a voice but not a vote in EU policymaking, of the kind it already has in NATO affairs.

Those hopes are ambitious but not absurd. They could all be realised within the space of five years if Russia now possessed, or was moving confidently towards, a liberal and democratic political model. But for the moment, to judge from the way President Vladimir Putin's second term has gone so far, Russia is moving in the opposite direction, towards increased authoritarianism. As one liberal Russian politician, Grigory Yavlinsky, summarised the trend in a talk last year:

> There are six major features of Russia which must be taken into account today. First, today Russia has no independent judicial system...Secondly...Russia has no elements of [an] independent parliament. Third, Russia has no public or parliamentary control on secret services and law-enforcement structures. Fourth, Russia has no [powerful] independent media. Fifth, elections in Russia are [subject to] very substantial pressure from the authorities...Last, but very important, Russia has an economic system which is in fact a 100% merger between business and authorities...Every single important bureaucrat in Russian government or Russian administration is at the same time deeply involved in businesses or represents their interests.

Very roughly speaking, and ignoring the rest of the former Soviet Union, Russia today is arguably where it might have been if it had avoided *perestroika* and the collapse of communism, choosing instead a Chinese path of strictly limited freedom. Under Mr Putin it has moved close to China's model of a one-party state, in which the ruling party (which in Russia is more of a clan), though a monopoly, cultivates real popularity as a source of stability and legitimacy.

The EU would be foolish to institutionalise closer ties while there is any risk that Russia will go on moving in this direction. Even if the EU feels comfortable with Russia now, that may change. Cutting new ties would be far more awkward, and far more insulting to Russia, than avoiding them in the first place.

EU members differ widely in their attitudes towards Russia. To the Balts and the Poles, Russia is a clear and present danger. It invaded them, unprovoked, within living memory. France sees Russia as a great diplomatic ally, another counterweight to America. Germany sees it as a vital economic partner, an indispensable supplier of gas. Britain is somewhere in the middle, shifting from optimism about Russia towards scepticism. The result is an absence of common policy, and in place of it a competition for Russia's friendship between France and Germany, which Britain used to join but rarely does now.

Relations could probably carry on that way, save that America's policy towards Russia and its neighbours has been changing, with and since the “orange revolution” in Ukraine. It is forcing choices on Europe.

To most west Europeans, the orange revolution was an inconvenience, something that would trouble relations with Russia and bring Ukraine to the EU's door as an unwanted candidate. Americans saw it differently, as the most inspiring event in Europe since the fall of the Berlin Wall and the revolt of the Baltic states. They were pleasantly surprised by the scale and the relative ease of Viktor Yushchenko's triumph over a Russian-backed challenger, and by what it revealed about the weakness or incompetence of Russia under Mr Putin. A stronger or cleverer Russia would have found a way to keep control. Russia also damaged itself in American eyes by renationalising the Yukos oil company. That has depressed potential investment and output across the Russian oil industry, just when America would have forgiven Russia almost anything in exchange for more and cheaper oil.

Perceptions of Mr Putin's weakness and drift, revealed and increased by the loss of Ukraine, appear to have become a new driver of American policy. America calls openly for the ousting of Alexander Lukashenka, the pro-Russian dictator of Belarus, implying another revolution there. In May George Bush visited Tbilisi to give public support to Mikhail Saakashvili, the pro-western president of Georgia, who is trying to close down Russian military bases on his soil—Russia says it will leave by 2008—and regain control over Russian-backed separatist enclaves. Only a year ago, America, although sympathetic to Georgia, was far more reticent.

This American assertiveness leaves the EU struggling to decide how to react. So far Europe's record has not been good. When Ukraine's orange revolution was gathering pace, west European governments were conspicuous by their hesitation. Luckily for Europe's self-respect, Poland sized up the situation and, helped by Lithuania, joined America in pushing for a fair election and an orderly transfer of power. More recently, the EU has spurned Georgia's plea for a mission to monitor its border with Russia.

Few doubt that durable democracy-building in Ukraine will be much easier if Ukraine has a clear prospect of EU membership within a meaningful time-frame. Ten years might be manageable, so long as other institutional ties came much sooner, giving Ukraine the sense of having joined, irreversibly, the European “family”. NATO is sending the right signals: it started an “intensified dialogue” with Ukraine in April that is widely seen as a prelude to membership.

Nothing of that sort is currently in prospect on the EU side, however. The EU has nudged Ukraine not to press publicly for early membership, in exchange for which the EU maintains a studied ambiguity about Ukraine's hopes of ever joining. Ukraine has done its best to obey that gagging order, but its hard-pressed new government is starting to hunger for some more constructive arrangement. Mr Yushchenko has proposed opening the question of Ukraine's candidacy if and when Ukraine successfully completes an “action plan” of economic and political reforms already agreed on with the EU, which should take about three years.

That sounds a good compromise, the sort of thing the EU should endorse. But the view in most western European capitals is that it will be at least ten years before the EU is ready to start talks about talks with Ukraine, and then only if it has more or less finished negotiations with Turkey. One or two EU governments may even be temporising deliberately as a way to reassure Russia, a more important goal in their eyes than reassuring Ukraine.

None of this is to say that bringing Ukraine into the EU would ever be an easy job. Ukraine is a big and very poor country, with a strongly russified east. The Yushchenko government has yet to inspire complete confidence. It has spent most of this year “fighting fires” instead of sticking to the intended agenda, says one adviser. Rivalries between ministers have made things worse. Anders Aslund, head of the Carnegie Endowment's Russian and Eurasian programme, says Mr Yushchenko's prime minister, Yulia Timoshenko, has been pursuing “socialist and populist” policies by raising state wages sharply, weakening property rights and increasing the tax burden. That contributed, Mr Aslund says, to a fall in the rate of economic growth from 12% last year to 5% in the first four months of this year.

In one sense, that might seem to hold some comfort for the EU. If the Yushchenko government does badly, there is even less pressure on the EU to take Ukraine seriously as a candidate. But that analysis is dangerously short-sighted. Ukraine has to come right, for its own sake and for Russia's. Russia is too big and too obstinate (and too tired of bad foreign advice) to take any notice of the EU's preaching on democracy and political reform. It might possibly be influenced, on the other hand, by the spectacle of a flourishing European-style market democracy in Ukraine, a country which Russians still feel to be an extension of their own.

Leading by example

This is a long shot. If a more authoritarian Russian regime is well entrenched and the economy is doing fine, a democratic Ukraine might well make very little impact at all. But if Ukraine's orange revolution does collapse, it is certain to extinguish any last support for liberal democracy which may have gone on flickering in Russia under Mr Putin. If Ukraine fails, with it goes any hope of changing Russia for the better in this generation, and with it any hope of a Russia that can rub along with Europe in genuine friendship.

The stakes are lower when dealing with the two other countries caught between Russia and the EU. But they are still worth playing for. One of them, Belarus, is a poor, sad place, isolated from the West since Mr Lukashenka took power 11 years ago. In that time he has descended from crude paternalism to outright dictatorship, supported by Russia. Popular revolution will be much harder in Belarus than it was in Ukraine or Georgia, because Mr Lukashenka has left no room for dissent to mobilise. He has bankrupted local NGOs and driven out foreign ones. His government controls all broadcast media and most print media too. Sparse private business survives only with the state's blessing. Political challengers risk being kidnapped or killed.

The other post-Soviet state, Moldova, is crippled by a Russian-sponsored separatist regime in its eastern province of Transdniestria. Russian troops helped local Russian settlers win a brief but bloody war of secession there after the Soviet Union collapsed in 1991, amid spurious claims that Moldova might be swallowed by Romania. The Transdniestrian enclave now floods the rest of Moldova with untaxed spirits and consumer goods smuggled in through Ukraine. It exports steel and small arms through Ukraine by day, and much nastier things by night. Transdniestria is, in effect, a big criminal racket with a small piece of land attached. Partition has paralysed and disoriented Moldova, making it the poorest country in Europe and the only post-communist country to have re-elected an unreformed communist party. But even Moldova's communists have switched their allegiance from Russia to the West, unable to stomach Russia's continued support for Transdniestria.

It beggars belief that Russia can claim international respectability while at the same time propping up Transdniestria and two other separatist enclaves in Georgia, South Ossetia and Abkhazia, which are just as far outside the law. And Mr Lukashenka's dictatorship in Belarus would have trouble surviving three

months without Russian support. “The Kremlin does not like Lukashenka, but it likes the orange revolution even less,” explains Anatoly Lebedko, one of Mr Lukashenka's brave opponents.

Straight talking

Here lies one way forward for Europe, and everyone else, in relations with Russia: brutal honesty. Whatever else Russia craves, it always craves respect. If western leaders challenge Mr Putin publicly about the smuggling and criminality in Transdniestria and South Ossetia each time they meet him, and if they press him publicly to condemn the dictatorship in Belarus, they will make these adventures much more expensive for Russia politically, at no great cost to themselves.

That will probably not spell the end for Mr Lukashenka, at least until Russia finds someone tamer who can still keep Belarus a no-go area for the West. But Transdniestria, South Ossetia and Abkhazia are another matter. Their continued existence serves the interests of crooks and nationalists and generals inside Russia, not the Russian government or state. Russia might let these enclaves go if they were doing serious damage to its standing in the world.

At the moment, however, most European leaders prefer to flatter Mr Putin. Even if they see his faults, they fear that whatever comes next will be worse. This may be so. But the answer, surely, is to do something to reverse that trend.

Europe has a better political and economic model to offer, but it has to make the virtues of that model clear to everyone. That means criticising Mr Putin's government for its undemocratic behaviour at home and its anti-democratic behaviour abroad. It means giving support to countries around Russia that want to do things differently. The aim of all this is not to weaken Russia, but to strengthen it, by encouraging it to govern itself better.

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Too big to handle?

Jun 23rd 2005
From The Economist print edition

Turkey's application to join the EU is causing anxiety on both sides

AP

Turkey's policing methods didn't go down well in Europe

THE desire of Turkey to join the European Union may well be the greatest tribute ever paid by an outside power to the EU's brand of liberal democracy. Both Turkey's secular elite and its moderate Islamic-backed politicians think that Europe's pluralist model can best protect their values and interests. With a lot of luck, both might be proved right.

But reaching an accommodation with Turkey also presents one of the biggest challenges faced by the EU in more than 30 years of admitting new members. Turkey is big, poor and populous. It sprawls from Europe into Asia. Its people are overwhelmingly Muslim, although its political institutions are secular. The EU's decision to declare Turkey a candidate for membership in 1999, 12 years after Turkey formally applied, was a bold move. Turkey was just starting to emerge from a “lost decade” in the 1990s, marked by “civil war, secular-Islamic polarisation, authoritarian proclivities, economic crisis and systemic corruption”, in the words of Omer Taspinar, co-director of the Turkey programme at the Brookings Institution, an American think-tank. It had suffered three military coups since 1960, four if you counted the army's help in bringing down a government in 1997. Weak and shifting coalition governments were the rule until the centre-right AKP party, appealing to moderate Islamic voters, won a landslide victory in 2002.

Turkey still falls far short of European standards in many areas of human rights, despite recent bold reforms. The German chancellor, Gerhard Schröder, one of Turkey's staunchest friends within the EU, said in May that the country's heavy-handed policing methods, limits on freedom of expression, and discrimination against women, were “incompatible with [Europe's] common values”.

Last year the EU declared itself ready to open negotiations with Turkey this coming October so long as Turkey met some last pre-conditions, mainly by bringing an amended penal code into force and extending its customs-union agreement with the EU to cover all the new members, including Cyprus. Turkey duly implemented the code in June and was also expected to extend the customs-union agreement, though without meeting Cypriot demands for access to Turkish ports and air space. Cyprus has been a sore point in Turkish-EU relations since Turkey invaded the northern part of the island in 1974 and installed an illegal government there. Cyprus joined the EU last year despite this de facto partition. Hopes for reunification have come to rest mainly with a United Nations peace plan that Turkey is willing to swallow, but which Cyprus thinks is too generous to the occupier.

Even if the accession talks do get started in October, the EU has gone out of its way to say that a successful completion cannot be presumed, still less guaranteed. At best, an accession treaty with Turkey may be ten years away. Even if one does comes then, France has promised a referendum on further EU enlargement, which in the present climate of opinion would certainly go against Turkey. Fear of Turkish entry probably played a significant role in the French rejection of the EU constitution in May.

Member or partner?

A change of government in Germany may do even more to hurt Turkey's perceived chances, if Mr Schröder loses the early election which he has called for the autumn. Opinion polls say that the next German government will be led by the Christian Democrats. Their policy is to make Turkey a “privileged partner” of the EU, but not a member. The rest of Europe knows that relations with Turkey are a vital national issue for Germany, which has a resident Turkish minority of almost 3m. Germany is also the biggest net contributor to the Union's budget. Germany alone could not secure Turkey's admission to the Union, but it could certainly block it.

A “privileged partnership” with Turkey might sound like a good compromise to many on the EU side. It may even sound attractive to a rising number on the Turkish side, where enthusiasm for Europe has been declining, though it is still high. A poll in May found that two-thirds of Turks wanted to join the EU, down from three-quarters a year earlier. Commentators said that the social and political changes needed to please the Europeans were upsetting nationalists and traditionalists.

This friction on the right may have played a part in the slowing of Turkey's reform programme this year, after the EU's agreement in December to open accession talks. The EU's chief of mission in Ankara, Hansjörg Kretschmer, in March spoke of “slippage”. He had in mind restrictions on foreign property ownership and on religious minorities, together with policing methods. The last of those made western headlines on March 6th when Turkish police beat women demonstrators in Istanbul. Instead of condemning the police, the government defended them.

Turkey's international image slipped further in April, with the commemoration of the 90th anniversary of Turkey's mass murder of Armenians in 1915. The government struggled to defend the Turkish version of events, and above all to reject charges of attempted genocide, when an apology for the many deaths that undoubtedly occurred, or simply a respectful silence, would have gone down much better abroad.

But if the government of Recep Tayyip Erdogan has not been looking its best this year, it can still point to some impressive achievements since the prime minister took office, including scrapping state security courts, cementing civilian control of the army, allowing Kurdish-language teaching and broadcasting, and shaking up the judiciary. These are the sort of things a country does when it is very serious indeed about trying to join the EU.

They are not, however, the sort of things a country does merely to have a “privileged partnership”. Russia claims a partnership with the EU, but makes no concessions to the EU's political or social agenda at all. If Turkey was to be told now, on the brink of starting its membership negotiations or even after, that the EU had changed its mind about membership, then Turkey would not feel “privileged” at all. On the contrary, it would feel frustrated and embittered, and understandably so.

The politicians who had bet their credibility on taking Turkey into the EU, and who had carried out controversial reforms as part of that project, would be discredited. Their reforms would be reviled, perhaps reversed. The country might retreat towards radicalisation and polarisation, in a geopolitical climate much more dangerous than that of the 1990s. Italy's foreign minister, Gianfranco Fini, said in May that a rejection from Europe at this stage might be enough to turn Turkey from moderate towards fundamentalist Islam. What price a privileged partnership then?

A Turkey successfully integrated into the EU, on the other hand, would be a great achievement in many ways. It would be evidence, to quote Mr Fini again, of the “compatibility of Islam with democracy”, setting an example for the Middle East beyond. It would bring an end to the division of Cyprus, removing the main potential trigger of fresh strife between Turkey and Greece. It would align more closely the interests and the memberships of the EU and NATO, so reducing the scope for tensions between the two: a separate European defence capability would become both easier to manage and less necessary.

With Turkish accession, the EU would extend into the southern Caucasus, helping to stabilise new pipeline routes bringing oil and gas westward from the Caspian. These will lessen Europe's energy dependence on Russia. A pipeline running from Baku in Azerbaijan, through Georgia, to Ceyhan in

Turkey, loaded its first oil in May. A European Turkey would also be under strong diplomatic pressure to normalise relations with Armenia, drawing Armenia closer to the West and opening up new possibilities for peace between Armenia and Azerbaijan. Georgia's hopes of following Turkey into the EU would be quickened, which would be all to the good. Georgia deserves much more support and encouragement from the EU for the political and economic reforms it has pushed through since President Saakashvili won power in the “rose revolution” of 2003.

America would like few things more than to see the EU and NATO working together to stabilise the Black Sea and the southern Caucasus. Energy exports aside, the region offers a bridgehead into what America calls the Greater Middle East, useful for projecting democratic values and military force. America has lobbied Europe repeatedly in past decades to be more welcoming to Turkey. Bringing Turkey into the EU would probably be easier now if both could turn to Washington as a common friend.

Iraq's shadow

Worryingly, however, relations between Turkey and the United States have deteriorated significantly since Turkey refused use of its territory for the invasion of Iraq in 2003. Turkey has fretted since about the possibility of a Kurdish state emerging in northern Iraq, giving fresh impetus to Kurdish separatism across the border in eastern Turkey. The choice this year of a Kurd, Jalal Talabani, as president of Iraq, may have helped calm Turkish fears, by giving the Iraqi Kurds a stronger interest in national unity.

Reuters

The old way for Turks to join the EU

In testimony to the Senate this year, Bruce Jackson, an influential American lobbyist for NATO expansion, said renewed tensions in Turkish-American relations were a sign that

> Turkey's national and geopolitical identity crisis is far from over and that Turkey may be entering a difficult and problematic stage...the ruling party seems to have taken a turn for the worse, characterised by strident anti-Americanism, cultural anti-Europeanism and a resurgent xenophobia...Perhaps most worrying are reports of Turkish-Russian discussions of a co-ordinated policy in the Black Sea region which would inevitably be conducted at the expense of smaller pro-European democracies...Turkey has entered a dangerous period both for itself and for -Turkish relations, which deserves serious attention.

That may be a harsh assessment. The Turkish government would certainly claim so. Its ministers have been insisting repeatedly this year that the talk of problems with America has been overblown. As if to argue the point, Mr Erdogan made his third official visit to Washington, DC, in early June. A month earlier he had been reaching out indirectly to America by visiting Israel, trying to repair relations which touched a low point last year when he accused Israel of practising “state terrorism” against Palestinians.

But still, America must doubt very much that Turkey shares its vision of radical change in the Middle East. The fundamentals of Turkish policy there include improved ties with Syria, touchy relations with Israel and fear of further upheaval in Iraq. It is rather as though Turkey's pro-Americanism worked well so long as America kept a respectful distance. It works less well when America is in Turkey's back yard, shaking up countries nearby and casting covetous eyes on the Black Sea. At such a point, says one western diplomat, Turkey's older instincts break ground. Where regional politics are concerned, it shows itself to be a “status quo” power, not a force for change.

Now that Turkey is approaching its EU entry talks, it may be discovering that Europe, too, looks better

from a distance. Accession talks can be humiliating at times, and Turkey may be less good than the central Europeans were at quietly putting aside national pride. It is, after all, the rump of an empire with a history as long and lofty as Europe's own. That makes its accession to the EU all the more desirable, and all the more difficult.

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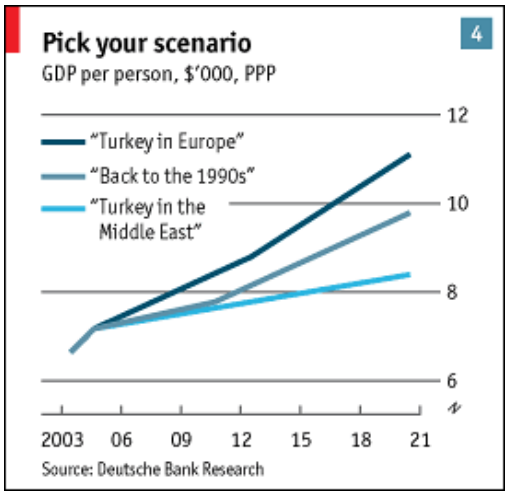
The 4% solution

Jun 23rd 2005
From The Economist print edition

Getting closer to Europe is good for economic growth



TURKEY'S population of 70m is growing at 1.1% a year, whereas that of most EU countries is stable or shrinking. According to Deutsche Bank, by 2020 the median age in Turkey will be only 32, compared with 45 in western Europe. Around the same time Turkey's population is forecast to pull ahead of Germany's, reaching 85m or more in 2035, whereas Germany's may fall below 80m. If west European countries ever get serious about liberalising their labour markets and creating jobs, Turkey can supply all the manpower they will need. Conversely, if they decide to keep cheap labour at bay, Turkey is the last country they will want at the door.

Deutsche Bank suggests three possible scenarios for Turkey over the next 15 years. In the first, Turkey pursues the economic and political reforms needed to converge with the EU; in the second, it drifts back to the weak governments of the 1990s, but with less economic volatility; and in the third, it is destabilised by geopolitical uncertainty, kept at bay by the EU and polarised by tensions between secular and religious forces. The long-term annual growth rates associated with these scenarios are, respectively, 4.1%, 3.1% and 1.9% (see chart 4).

Daniel Gros, director of the Centre for European Policy Studies in Brussels, argues that if Turkey can improve its business climate, attract more foreign investment and redeploy its workforce more productively as part of a successful EU accession, then over the long term its annual growth rate could be 3-6 percentage points a year ahead of that in west European countries and 1-3 points a year ahead of central European countries.

Long-term forecasting is a particularly inexact science as applied to Turkey, Mr Gros notes, because its recent performance has been so volatile. Given the macroeconomic instability of the past decade, it is almost a surprise to find Turkey notched up any growth at all over that period. But Mr Gros finds perverse encouragement in its recent record. If the Turkish economy could survive the political ill-treatment it received in the 1990s, he says, then deep down it must be very robust indeed.

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The shape of things to come

Jun 23rd 2005
From The Economist print edition

The European Union should go its different ways

Reuters

It worked for them

“THIS is my grandfather's axe,” as a Polish saying has it. “My father changed the blade, and I have changed the handle.” Almost everything about the European Union has changed since it was first put together. The six founding countries are outnumbered threefold by those who have joined since. There is no longer a communist threat from the east, uniting western Europe against it, with America at its back. There is no credible threat or expectation of war anywhere in Europe, save perhaps for the fear of civil conflict in the Balkans or Moldova. Of course history must be remembered, for fear that it may be repeated. But the question now is what the EU can do for its citizens in the future, not what it has done for them in the past. And from there it is a short step to asking whether the Union can hold together at all.

This survey has guessed that it will, but argued that the disaggregation of Europe into overlapping projects and groups will continue and that any future members will have to accept some exclusions. They may not share in the Schengen zone of passport-free travel, nor enjoy free movement of labour, nor receive direct farm subsidies, nor have a vote on “constitutional” issues touching on the Union's basic rules and powers. Indeed, the Union reserved some of these options last year when it decided in principle to open negotiations with Turkey. Such restrictions will anger countries waiting to join the Union. But by answering to the main worries in western public opinion about further enlargement, they may be decisive in making it possible for Turkey, or Ukraine, or the countries of the Balkans, ever to join at all.

The big unknown is whether the prospect of a more restrictive form of membership would still be enough to promote deep political and economic change in candidate countries, of the kind already seen in central Europe. The answer is probably yes. And it is certainly worth trying, if it is the best offer the EU can hope to make. A restrictive membership could still be “sold” as a membership to voters in the candidate country. It would give them a vital sense of belonging. The accession process would expose politicians and civil servants to the full weight of peer pressure within the EU institutions. And any restrictions would probably prove to be temporary, once the newcomer had a track record as a Union member.

The Union is, moreover, better equipped than ever to integrate new members, however big and difficult they may be. The countries of central Europe are on hand to give advice and pass on experience to their neighbours to the east. They can offer reassurance that the principles of reform, properly applied, do work on even the most vandalised economies.

The European Commission has become a highly skilled manager of the accession process. It has written the book on member-state-building. Any country that truly wants to adopt a European model, and is prepared to give that project a clear run of five years or so, under the tutelage of Brussels, can reasonably expect success. Even if a country decides in the end not to join the Union, or is rebuffed, it will have had five years of institution-building and policy-anchoring. A country made ready to join the European Union is a country better able to compete in the world whatever course it chooses.

A Union accommodating shifting alliances of members, sometimes pulling in different directions, is inevitably going to be less cohesive and less effective as an international actor. If countries no longer think that they are moving towards a full political union, they have much less incentive to align on big issues of foreign policy. But perhaps the idea of a common foreign policy for Europe has already lost its charm with the Iraq crisis. Whether you subscribed to the British position on Iraq or the French one, you would not have wanted to be trapped in the opposite camp and forced to support a policy which you believed would ruin relations with the Middle East, or with America, or both.

Smaller alliances will become the rule in foreign policy—and even these will be shifting ones. France and Germany have been remarkably intimate under President Chirac and Chancellor Schröder, enough to promote periodic talk of a much deeper bilateral union, for example. But relations might be less indulgent between a Germany run by Angela Merkel and a France run by, say, Nicolas Sarkozy.

The weaker a common foreign policy, the weaker any European Defence Identity, or whatever it comes to be called. Instead, NATO can reassert its historic role as the sole plausible vehicle for common European defence. The countries of central and eastern Europe will put even more weight on NATO, and on their bilateral ties with the United States, as guarantees of the hard security that Europe looks less and less likely to provide, especially with respect to Russia. Traian Basescu, when elected president of Romania in December, caught the mood of his region by announcing that he would pursue a "Bucharest-London-Washington" axis in foreign relations, pointedly neglecting to mention Brussels or Paris or Berlin. He appears to have decided that, although the prosperity of his country will best be assured by joining the EU, its security will best be assured by making it conspicuously useful to the United States.

Taken together, the great trends of the moment touching upon Europe and its neighbours—the weakening of the EU, the hardening of Russia, the confrontation between Islam and democracy in the greater Middle East, and the resurgence of American interest in eastern Europe and the Black Sea region—suggest a period of what two American commentators, Ronald Asmus and Bruce Jackson, have called "strategic fluidity", in which countries may glimpse new possibilities and be tempted to make bold changes of direction. Mr Asmus and Mr Jackson argue, for example, that Israel should draw much closer to both the EU and NATO, perhaps joining them, as the Middle East and Europe merge into the same "security space".

The idea of fluidity is inseparable from that of unpredictability. Look back to 1995, and it was much easier to predict what the EU and its neighbours would look like in ten years' time. You would have bet on an EU that had enlarged, or was about to, into central Europe; a Turkey still banging at the door; a messy but probably no longer warring Balkans; and a Russia gruffly going its own way, dragging neighbouring countries in its wake. You would have been right on all counts, save for the revolt of Ukraine, and even that is not irreversible.

AP

Basescu picks his axis

Looking ten years ahead from today, we might bet that nothing in that landscape will have changed at all, save that the Balkans will continue their slow recovery. If so, that would count as a good result—compared with, say, a decade in which the EU fell apart, Turkey grew more polarised and radicalised, the Balkans stayed restless, and civil strife broke out in the southern Caucasus and Moldova.

Give it time

This survey has argued for a best-case result in which the EU goes on using the power of membership to change the countries around it for the better. But Europe is much less likely to find the energy and the generosity for that strategy, now that it has lost its sense of purpose and confidence in itself. How can those things be restored?

The best hope is democracy itself. Given enough time, voters have a great gift for getting things right. Economic stagnation has forced an early election in Germany. When France emerges from its current identity crisis, it must surely also want big changes in national policy. If these two struggling giants of Europe, Germany and France, can regain some of their poise and confidence, then so can the EU as a whole.

We may, in other words, have to wait five years or so before we can even sketch in the political contours of a wider Europe ten years hence, before we can say whether the EU will be strong and inclusive or weak and exclusive. That uncertainty must make the EU an infuriating partner with which to deal. It is so often moody, self-absorbed and hard to understand. But of all the powers and empires in the world, it is still the one that most countries on its fringes would want as their neighbour.

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Sources and acknowledgments

Jun 23rd 2005
From Economist.com

This survey borrows ideas from many people. Some are identified in the text. In addition, and without implying they would necessarily agree with the views expressed here, the author would like to thank: Lajos Bokros, Robert Braun, Martin Bruncko, Robert Cooper, Pavol Demes, Jeremy Druker, Michel Foucher, Andrew Gardner, Heather Grabbe, Charles Grant, Istvan Gyarmati, David Kral, Mart Laar, Edward Lucas, Alina Mungiu-Pippidi, Jiri Pehe, Sandra Pralong, Olli Rehn, Gyorgy Schopflin, James Sherr, Pirkka Tapiola, Emma Udwin and Alexander Vondra. Three books, all published this year, proved of particular value: "The New Political Economy of Emerging Europe", by Laszlo Csaba; "The System Made Me Do It", Rasma Karklins; and "How the East Was Won", by Charles Paul Lewis.

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Information security

The leaky corporation

Jun 23rd 2005
From The Economist print edition

Firms are not protecting the data they hold. Their complacency may cost them dear

Get article background

IT NEVER rains but it pours. Just as bosses and boards had finally sorted out their worst accounting and compliance troubles, and beefed up their feeble corporate governance, a new problem threatens to earn them—especially in America—the sort of nasty headlines that inevitably lead to heads rolling in the executive suite: data insecurity. Left, until now, to geeky, low-level IT staff to put right, and seen as a concern only of data-rich industries such as banking, telecoms and air travel, information protection is now high on the boss's agenda in businesses of every variety.

Several massive leakages of customer and employee data this year—from organisations as diverse as Polo Ralph Lauren, Time Warner, MCI, the large American defence contractor Science Applications International Corp and even the University of California, Berkeley—have left managers hurriedly peering into their labyrinthine IT systems and business processes in search of potential vulnerabilities.

“Data is becoming an asset which needs to be guarded as much as any other asset,” says Haim Mendelson of Stanford University's business school. “The ability to guard customer data is the key to market value, which the board is responsible for on behalf of shareholders”. Indeed, just as there is the concept of Generally Accepted Accounting Principles (GAAP), perhaps it is time for GASP, Generally Accepted Security Practices, suggests Eli Noam of New York's Columbia Business School. “Setting the proper investment level for security, redundancy, and recovery is a management issue, not a techie one,” he says.

The mystery is that this should come as a surprise to any boss. Surely it should be obvious to the dimmest executive that trust, that most valuable of economic assets, is easily destroyed and hugely expensive to restore—and that few things are more likely to destroy trust than a company letting sensitive personal data get into the wrong hands.

Don't ask, don't tell

Such complacency may have been encouraged—though not justified—by the lack of legal penalty (in America, but not Europe) for data leakage. Until California recently passed a law, American firms did not have to tell anyone, even the victim, when data went astray. That may change fast: lots of proposed data-security legislation is now doing the rounds in Washington, DC. Meanwhile, the theft of information

about some 40m credit-card accounts in America, disclosed on June 17th, overshadowed a hugely important decision a day earlier by America's Federal Trade Commission (FTC) that puts corporate America on notice that regulators will act if firms fail to provide adequate data security.

The FTC decided to settle with BJ's Wholesale Club, a retailer whose lax data-protection practices the agency said constituted an "unfair practice that violated federal law." The firm collected too much data, kept it too long, did not encrypt it, lacked password protections and left its wireless network open. This, in turn, enabled criminals to produce counterfeit credit and debit cards using stolen customer data and rack up millions of dollars in fraudulent charges. The firm has agreed to fix these problems and undergo information-security audits for 20 years.

This settlement represents a big step for the FTC, which had settled various other cases concerning sloppy data management since 2001—including against Eli Lilly, clothing designer Guess, Tower Records and Microsoft—but did so on narrow, technical grounds. For instance, in several cases the FTC applied the doctrine of "deceptive practices" to firms that failed to live up to their data-security claims.

Many of the worst recent data leakages resulted from failure of the most basic kind

In its settlement with BJ's, the FTC used its broad "fairness authority" to penalise bad information-security management. For the FTC to act, this requires evidence both of substantial consumer harm and that the firm did not have reasonable grounds for failing to implement certain practices. The BJ's case, said FTC chair Deborah Platt Majoras, signalled the regulator's "intention to challenge companies that fail to protect adequately consumers' sensitive information".

"Boards should pay as much attention to these IT operational risks as they do to other operational risks in the firm," argues George Westerman of the MIT Sloan School of Management. After all, boards have audit committees and compensation committees. It may be time for a data-protection committee, he argues. Bosses must ensure that there are effective data risk-management processes in place, be aware of their greatest vulnerabilities and promote a corporate culture that acknowledges data risks rather than hides them.

But the problem is often a lack of understanding by senior managers not just of technology but of business processes, says Thomas Parenty, author of "Digital Defense: What You Should Know About Protecting Your Company's Assets (Harvard Business School Press, 2003). "No one in the organisation bothers to look at the value of what data they hold, the consequences if something bad happens to it, and the appropriate mechanisms to prevent that from happening," he says.

So, what should a boss do? Accountancy firms and consultants are already spotting a chance to profit by conducting an independent security and privacy audit—and for many firms, their (no doubt) huge fee will probably be worth the money. The auditors inspect technology systems, data flow and the controls on access to data within an organisation and with its business partners.

A wise boss will also appoint a senior executive to be responsible for data security—and not just to have a convenient scapegoat in the event of a leak. Diana Glassman, a data protection expert, says that a useful first step would be for the boss to write to all employees reminding them of the risks and potential cost of data leakage, and asking them, before passing data to anyone else, to question whether that person truly needs, or is entitled to, it.

Many of the worst recent data leakages resulted from failure of the most basic kind. The data-processing firm that suffered the breach that exposed 40m credit-card accounts was not in compliance with the security standards of Visa and MasterCard—which may now find themselves liable for negligence. If nothing else gets bosses to focus on data security, surely the prospect of ending up in court will.

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Mobile e-mail

The CrackBerry backlash

Jun 23rd 2005
From The Economist print edition

You can have too much BlackBerry

THE BlackBerry, an iconic pocket-sized e-mail device, has millions of devoted fans—but increasingly has its critics, too. “My wife has banned me from using it at weekends,” moans one technology industry executive. At a recent technology conference organised by *The Economist*, the question of “CrackBerry” dependency, rather than grid computing or web services, was one of the hottest topics. The winner of the British version of “The Apprentice”, a reality TV show, has admitted that his wife has threatened to flush his BlackBerry down the toilet. Meanwhile bosses grumble that nobody pays attention in meetings any more, because they are so busy doing e-mail under the table. It takes over your life! It ruins your marriage! It distracts you at work! The BlackBerry backlash, it seems, has begun.

The rise of the BlackBerry is part of a wider trend, as wireless and broadband technologies make it possible to work any time, anywhere. But blaming communications technologies for their social consequences is shooting the messenger. This has been going on since the mid-19th century, when telegrams were introduced. “The businessman of the present day must be continually on the jump—he *must* use the telegraph,” grumbled one New York merchant in 1868. With each new gizmo, most people eventually discover a sensible work/life balance. It just takes time to adjust.

True, wireless devices pose a particular challenge, because they work anywhere. As a result, users themselves must decide when to use them for work and when not to—and many people, it seems, are so far unable to decide where to draw the line. “It's wonderful that we can work anywhere now, but at the same time we need rules for ourselves,” says Andrew Brown, a mobile-computing specialist at IDC, a consultancy. In some cases, he says, workers have refused to use mobile e-mail devices, or have given them back. Less drastically, P. Diddy, a rap star, is reported to have switched off his BlackBerry for a few weeks while he appears in a Broadway play. Is he the first celebrity member of the growing, happy band of recovering CrackBerry addicts?

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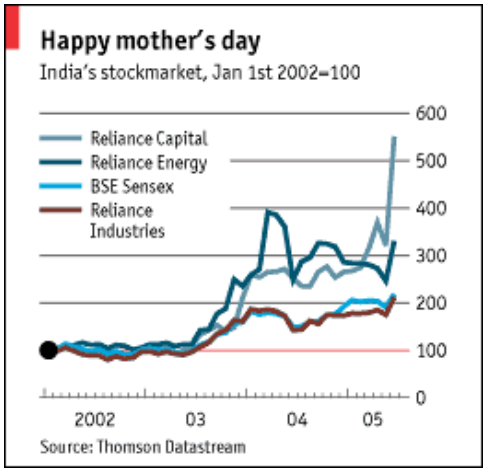
Indian business

Hand rocks cradle

Jun 23rd 2005 | DELHI
From The Economist print edition

Reliance is split between two feuding brothers—by their mother



THE Bombay Sensex index soared to a record high after the news on June 18th of an end to the seven-month public feud in the Ambani family, which controls Reliance, one of India's biggest business groups. The firm is to be split between the two battling brothers: Mukesh, the 48-year-old chairman of Reliance Industries (RIL), the main group company, and Anil, who is 46. Euphoria at the truce was understandable; but so was frustration at the vagueness of its terms.

The government seems loth to spoil the party by pursuing the many complaints of poor governance that Anil Ambani has been throwing at RIL and his brother. Palaniappan Chidambaram, India's finance minister, said he was "happy" a settlement had been reached and saw no need for any inquiry. Kokilaben Ambani, mother of the brothers, had issued a statement on the morning of June 18th that, "with the blessings of Srinathji" (her Hindu god), she had "amicably resolved the issues" between her two sons.

Mukesh Ambani will now, as expected, have "responsibility" for RIL and IPCL (a petrochemical company). Anil will take three smaller companies—Reliance Infocomm, Reliance Power and Reliance Capital—that are to be demerged from RIL.

This followed late-night talks driven by Mrs Ambani on the advice of religious astrologers consulted by the group on the timing of all decisions. Yet no more detail was revealed about when and how the empire will be split and ownership swaps financed. Nor was it explained why Mrs Ambani's statement referred to "responsibility" rather than ownership or control.

A RIL board committee is working on a complete, tax-efficient separation of ownership and control, along with an agreement not to compete. Analysts who think that the terms are already settled grumble about the family's typical lack of transparency. "All they've told us is how much they love each other," said one investor, pointing to emotional messages sent by the brothers to group companies that they are leaving.

Founded in 1958 by Dhirubhai Ambani, father of the brothers, who died in July 2002, RIL made net profits of $1.7 billion in 2004-05 on revenues of $16.7 billion, which seemed unaffected by the brotherly acrimony. Mukesh will inherit businesses with proven records in areas ranging from textiles and petrochemicals to oil refining and exploration. Anil, in what he is calling the Anil Dhirubhai Ambani Enterprises group, gets to run new consumer-oriented telecoms and finance firms as well as big infrastructure projects.

While Mukesh retreated last weekend to a wedding party in Goa, Anil defied his party-going image by holding board meetings and a press conference, breaking off only for a family visit to a Hindu temple patronised by leading businessmen. He said that he will personally invest 30 billion rupees ($690m) to help finance projects costing $16 billion that Reliance Energy is chasing, and to build Reliance Capital into one of India's biggest finance firms. Plans for Infocomm will follow soon—including, no doubt, a public share offering to raise urgently needed funds. But will the sibling rivalry end now that the two boys each have their own toys?

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Motor racing

On the skids

Jun 23rd 2005
From The Economist print edition

Formula One loses the plot

EPA

Fun for all the family

IF THE lucrative business of Formula One motor racing (F1) had set out to become a laughing-stock in front of hundreds of millions of TV viewers worldwide, could it have bettered its US Grand Prix at Indianapolis on June 19th? After a warm-up lap, 14 of the 20 cars due to take part pulled out, citing “safety grounds”. The “race” started with only six cars, as angry spectators, who had paid $100 or more for tickets, threw beer cans and water bottles.

After investigating the failure during practice of one of its tyres on the final corner of the circuit, Michelin, one of two tyre suppliers to F1, had announced on the eve of the race that it could not guarantee the safety of its product. The only way that the seven teams with Michelin's tyres could race safely was if they reduced the speed of their cars on the final turn.

Max Mosley, president of the sport's governing body, the Fédération Internationale de l'Automobile (FIA), rejected a compromise, agreed to by nine of the ten F1 teams, which would have reduced the speed of all 20 cars on the final turn and produced a proper race. He did so on the grounds that it would have been “grossly unfair” to the three teams supplied by Bridgestone, Michelin's rival. The seven Michelin teams rejected as too risky a compromise suggested by the FIA restricting the final-turn speed of just their cars.

The seven teams had strong incentives to compromise: they attract sponsorship from American firms, and want more; America—where F1 has lately been trying to establish itself—is a crucial market for BMW, Honda, Mercedes and Toyota, big carmakers behind four of the seven teams.

Michelin admits that it “screwed up”. Its tyres failed because it had overreached in its desire to beat Bridgestone. But at least the firm deserves credit for confessing its safety concerns. The anger of most of the F1 teams is directed not at Michelin but at Mr Mosley, for his apparent intransigence. Mr Mosley, who is up for re-election this year, blames Michelin and the teams.

The wider context of the farce on the track at Indianapolis is a power struggle off the track. Of the six car carmakers who own, part-own or back a F1 team, only one (Ferrari, part of Fiat) has committed itself to F1 after the current contracts governing the sport expire at the end of 2007. Instead, three of them are threatening to set up a rival championship from 2008, and will probably be joined in the near future by the other two teams. Above all, they want a greater say—and a lesser role for the FIA—in the sport's future.

If any of these carmakers needed a clinching argument for a championship with a new regulatory structure, then the grand prix at Indianapolis surely provided it. Relations between the FIA and most of the larger teams were already severely strained. Unanimous agreement of the teams was supposedly needed to change regulations before 2008, but Mr Mosley pushed through changes for this season without the support of all the teams, using a safety clause in the sport's governing agreement. These changes included a one-tyre-per-weekend rule. Previously, unlimited tyre changes were allowed. Few in the sport really believe that reducing tyre choice in any way improves safety.

Last week, the FIA unveiled plans to further downgrade the role of technology after 2007. This change, which the FIA says will make F1 more a battle of skill, would reduce the influence of the carmakers.

“Arguably, some €1.35 billion ($1.6 billion) is being completely wasted in F1 each year by the six manufacturers,” said the FIA.

Only a year ago, few in the sport believed that an alternative to F1 would ever get started. After Indianapolis there are fewer doubters. If Mr Mosley stands and is re-elected, F1 could well collapse, and a new, rival championship in 2008 will become a racing certainty.

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Corporate crime in America

Off to jail

Jun 23rd 2005 | NEW YORK
From The Economist print edition

A bad week to be bad

TIME was when prosecutions of corporate executives ended with a whimper not a bang. Starting against a backdrop of outrage, they droned on endlessly amid a mass of convoluted detail, before ending with the perpetrators sent to fairly nice jails for shortish periods.

How different things have become was evident in the past week. On June 17th, Manhattan's district attorney, Robert Morgenthau, prevailed in a long retrial over Tyco's former chief executive, Dennis Kozlowski, and its former chief financial officer, Mark Swartz, who were convicted of grand larceny, conspiracy and fraud. They face a sentencing hearing on August 2nd and a maximum penalty of 30 years behind bars. The full term is unlikely, but a decade or so seems probable. On June 20th, in a courtroom a few hundred feet away, John Rigas, former chief executive of Adelphia Communications, was sentenced to 15 years in jail. His son Timothy, formerly the cable company's chief financial officer, got 20 years. They stole $100m and hid $2 billion in corporate debt, thus looting and defrauding shareholders.

As tough as Mr Rigas senior's sentence was, the district judge, Leonard Sand, said that it would have been longer but for his age (80) and health (not good). In receiving these long terms, they join several other formerly prominent executives who had the misfortune to face sentencing within the past two years, including Andrew Fastow of Enron (ten years), Martin Glass of Rite Aid (eight years), Jamie Olis of Dynegy (24 years) and Sam Waksal of ImClone Systems (seven years). Next up: Bernie Ebbers, the former chief executive of WorldCom, who will be sentenced on July 13th for his part in a massive accounting fraud. Mr Ebbers, aged 63, fears that he will get, in effect, a “draconian life sentence”. In the 1980s, during the last major outbreak of corporate malfeasance, most sentences could be measured in months, not years.

A common element in both the Tyco and Adelphia cases was the decision by local and federal prosecutors to go after individuals rather than the companies that employed them, a strategy that sharply diverged from the approach taken by New York state's attorney general, Eliot Spitzer, in his pursuit of errant big financial firms. Mr Spitzer preferred to extract large financial settlements from the firms, leave most executives in place, and prosecute almost none. With the key executives, alone, facing the music, shareholders and employees of Adelphia and Tyco were not only spared from having to suffer the continued management of crooks, but also from paying for the privilege. Tyco, post-Kozlowski, has made a brilliant recovery, saving thousands of jobs and providing a huge financial bounce for investors. Adelphia's assets were auctioned off: bids have exceeded expectations and investors have enjoyed at least some bounce.

These contrasting prosecutorial strategies raise difficult questions about the correct way to address corporate malfeasance. Even in the Tyco and Adelphia cases, where the targeting only of individuals did much to spare the firms, there is controversy about whether investors would have been even better off had the culprits been pursued with civil rather than criminal charges. Then, the emphasis would have been on recovering still more money for the firm, rather than on punishment. But what about retribution? And what about deterring future crimes?

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Telstra

A wise move?

Jun 23rd 2005 | SYDNEY
From The Economist print edition

Solomon Trujillo takes Australia's toughest corporate job

IT IS Australia's biggest telecoms firm and its second most-valuable company, but Telstra is in trouble. Now it is bracing itself for change. On July 1st, Solomon Trujillo, a 53-year-old American, will become its new boss. His arrival coincides with federal government plans to sell its 51.8% stake in Telstra, in what would be Australia's biggest ever share offering. Mr Trujillo must ready the firm for sale—a task that many consider to be Australia's toughest corporate job.

Telstra's problems stem in part from its roots as a state-owned monopoly, Telecom Australia. Since deregulation of Australia's telecoms industry began about 15 years ago, Telstra has suffered falling revenues from its core fixed-line business and tough competition from new rivals, such as Optus, in mobile-telephony and broadband.

A sale has long been a priority for John Howard's conservative-led government. It floated one-third of Telstra in 1997 and a further 16.6% in 1999, raising about A$30 billion ($23 billion); the remaining stake is valued at about A$33 billion. But selling the final chunk was impossible without government control of the federal Senate. Last October, Mr Howard unexpectedly won a Senate majority. That will take effect in July. In August, the government plans to introduce legislation authorising the sale, although the float is not expected before mid-2006. By then, Mr Trujillo must convince investors to buy. Those who invested in the earlier offerings have been disappointed. In 1999, for instance, the shares were priced at A$7.40. On June 9th, when Mr Trujillo was appointed, they traded for barely A$5.

Two episodes in particular shook public confidence in Telstra under Ziggy Switkowski, Mr Trujillo's Australian predecessor, who quit last December. One was an ill-fated bid to enter the Chinese market by buying CSL, a mobile operator based in Hong Kong. That left Telstra with big losses. The other was the revelation last year that Telstra was seeking to buy control of John Fairfax Holdings, one of Australia's leading newspaper firms. The notion of a government-controlled firm running a newspaper caused outrage in the Australian media. The debacle prompted Bob Mansfield, Telstra's chairman, to resign.

Mr Trujillo's most recent job was chief executive of Orange, a big European mobile phone firm, which he left last year, apparently after a clash with France Telecom, its fixed-line parent. Before that he spent over 20 years at US West, an American phone operator, ending up as chairman and chief executive and overseeing its merger with Qwest, a rival. Analysts in Australia have greeted Mr Trujillo's appointment, after a six-month search, with what one of them calls “moderate warmth”.

In devising a new growth strategy for Telstra, Mr Trujillo must navigate unfamiliar and tricky political ground. The National Farmers' Federation, a powerful lobby, opposes the sale, arguing that a privatised firm would ignore customers scattered over Australia's outback, where services are hard to maintain. The National Party, the rural-based junior partner in the government coalition, has yet to endorse the float. In fattening Telstra for sale, Mr Trujillo may need to call on all his experience in America's wild west to win them over.

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German business

Lacking energy

Jun 23rd 2005 | FRANKFURT
From The Economist print edition

Botched energy liberalisation could kill an aluminium plant

A POKER game this week over the future of Hamburger Aluminium-Werk (HAW) has highlighted the weakness of Germany's half-baked energy liberalisation. The three owners of HAW, an energy-hungry smelter, have decided to close it by the end of this year if it cannot get cheaper electricity. Last week, HEW, a local power firm owned by Vattenfall of Sweden, offered a lower price which, it said, was the best it could do. “We'll be the first aluminium plant to close in Europe,” lamented Hans-Christof Wrigge, the boss of HAW.

The problem, all agree, is rocketing energy prices, more marked in Germany than in the rest of Europe and beyond. Higher oil prices have been abetted by under-capacity, tough green laws on renewable energy, the phase-out of nuclear power and a transmission grid unable to cope with the biggest collection of wind farms in the world. All this is combined with imperfect price competition: the market is dominated by four major producers, two of which also control a large part of the grid. Setting up a European Energy Exchange (EEX) in Leipzig was a nice idea, but producers have an information advantage and liquidity is scarce.

A new energy bill, agreed last week and likely to be passed on July 1st, should improve competition on the grid. But German energy policy has generally been influenced by many interest groups rather than the national interest, says Berthold Hannes of A.T. Kearney, a consultancy.

Spot power prices on the EEX have risen, somewhat inexplicably, from around €25 ($27) per mega-watt hour in January 2003 to over €40. Discounts for big users are tiny because of the heavy extra costs imposed by the government to subsidise renewable energy sources (due to provide 20% of capacity by 2020) and to reduce the life of nuclear power plants to 32 years (from 50 years). Big producers and grid owners are having to invest billions more to accommodate these two factors.

The likely election of a conservative government in September has given the nuclear lobby fresh hope. Angela Merkel, the favourite to be chancellor, has hinted at lengthening the life of nuclear plants. But building new plants will probably remain unacceptable to the German public.

That leaves Germany facing a long-term capacity shortage that will not be solved by renewable energy. Dena, a government-sponsored energy think-tank, calculates that wind-power will replace only 6% of Germany's conventional energy needs. Meanwhile, power companies such as Vattenfall Europe are working on developing cleaner thermal plants.

None of which will come in time to save the Hamburg smelter, though HEW and Norsk Hydro, which owns one-third of HAW, may yet cut a deal. HEW is owned by Vattenfall which produces power in Scandinavia, as does Norsk Hydro. An energy swap contract that would supply power to HAW at Scandinavian rather than German prices (closer to €30 per mega-watt hour than €40) may be agreed. That would only underline the inefficiency of Germany's energy market.

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Advertising

Adland's bitter feud

Jun 23rd 2005
From The Economist print edition

The boss of Havas has lost his fight against France's top corporate raider

EPA

An ace up Bolloré's sleeve?

FOR almost a year Alain de Pouzilhac, the boss of Havas, and Vincent Bolloré, France's best-known corporate raider, have fought an increasingly acrimonious struggle over strategy and control of the big French advertising firm. On June 21st, during a heated five-hour board meeting, Mr de Pouzilhac agreed to quit. Richard Colker, an independent board member, will run the firm until a successor is found.

What a sorry end to Mr de Pouzilhac's 16-year reign at the world's sixth-biggest ad company. The medium-sized firm he leaves looks ripe for acquisition in an industry now dominated by the big four—America's Omnicom and Interpublic, Britain's WPP and France's Publicis—and many small, nimble agencies. Mr Bolloré's manoeuvres only add to the speculation.

During the past few months Mr de Pouzilhac had seemed to be winning. Mr Bolloré had gradually acquired 22% of the firm, but Mr de Pouzilhac had waged an effective campaign in the French press portraying Mr Bolloré as a ruthless profiteer. He rallied support from thousands of shareholders. Workers were unwaveringly loyal. Shareholder activists, such as America's Institutional Shareholder Services, backed his categorical refusal to grant Mr Bolloré any seats on the Havas board.

Yet Mr Bolloré had some heavyweight support of his own, not least Claude Bébéar, the influential chairman of Axa, a big insurer, and Deminor, a consultancy specialising in shareholder rights. Both said his demands for board seats were legitimate: in France, shareholders with far smaller stakes usually get on the board.

Then came trouble at the annual shareholder meeting on June 9th, as Mr Bolloré joined forces with Sebastian Holdings, the holding company of Norwegian investor Alexander Vik, owner of a 4.9% stake in Havas. Mr de Pouzilhac had thought Mr Vik an ally, with some reason. But he—crucially—backed a resolution to appoint four members of the Bolloré camp to the board. Mr de Pouzilhac's exit became inevitable.

His successor is expected to be Mr Bollore's preferred candidate, Jean-Marie Dru, boss of TBWA, part of Omnicom. According to reports in the French press, Mr Dru will take over in September.

Mr Bolloré insists that he does not want to buy Havas, merely to be its most important shareholder. He wants to make Bolloré Médias Investissements, his newish media holding-company, an integral part of his €5 billion ($6 billion) shipping-to-cigarette-paper conglomerate.

Yet his corporate-raider past suggests that, if he is becoming a strategic long-term investor, it is by default. Havas had seemed a perfect raider target: undervalued, having lost €396m in 2003, but needing little more than a shake-up at the top.

Mr Bolloré may have hoped to orchestrate a bidding war. But, so far, neither private-equity firms nor the big four are showing much interest in Havas, says Nicolas Gindre at Kepler Equities, a brokerage. Private equity fears a client exodus in reaction to the uncertainty over the firm's future. Omnicom has grown organically. Interpublic is troubled by accounting irregularities and client losses. WPP is still digesting the takeover of Grey Global, a big American firm. Publicis does not want to risk conflict between its clients

and those of Havas.

Could the group be broken up? Euro RSCG, an agency network, is responsible for the bulk of the Havas's revenue. Other subsidiaries such as MPG, its media-buying arm, and its health-care communications business might tempt WPP and Publicis, but their successful sale would not compensate for a failure to sell RSCG for a good price. Anyway, Mr Bolloré denies break-up plans.

Alternatively, Mr Bolloré has the option of selling down his stake. Yet although shares in Havas have jumped since he started to buy them, they would quickly fall if he were known to be selling. So Mr Bolloré will probably remain an investor for a while. Perhaps he wants to become the new Lagardère, says Pierre Bucaille at Fideuram Wargny, a private bank. Over the past few years, Arnaud Lagardère has turned Lagardère, his father's defence firm, into a big media group. Thanks to a raid that backfired, Mr Bolloré may be embarking on a second career.

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Face value

China's gas guzzler

Jun 23rd 2005
From The Economist print edition

Fu Chengyu must balance China's thirst for energy with its desire for corporate respectability

FOR a man about to make the biggest decision of his career—one that could trigger a huge political backlash in America—Fu Chengyu seemed remarkably relaxed earlier this week. Sitting in a stately meeting room in his Beijing offices, the blunt, English-speaking 54-year-old chairman and chief executive of China National Offshore Oil Corporation (CNOOC) joked that the outcome could "make me a hero or a martyr". On June 23rd Mr Fu took the plunge, making an offer of $18.5 billion (excluding debt) for Unocal, a California-based oil and gas company.

This is the largest foreign takeover yet attempted by a Chinese firm—and a contested one, to boot. On April 4th, Unocal agreed to be acquired by Chevron, the second-biggest American oil firm, in a deal worth $17 billion (excluding debt). With Sino-American relations already strained, the prospect of a state-owned Chinese company buying a big American energy firm is causing ructions in Washington, DC, ostensibly over potential national-security risks, and may also do so elsewhere in Asia, where most of Unocal's gas reserves are located.

Mainland China's top companies are becoming increasingly ambitious and aggressive in their pursuit of foreign assets, their competitiveness boosted by ready access to (effectively free) state cash. Last month, computer-maker Lenovo completed its $1.75 billion acquisition of IBM's personal-computer operations. On June 20th, Haier, China's leading white-goods maker, launched a $1.3 billion cash offer for Maytag, an ailing American rival, trumping Ripplewood, a private-equity firm. But the Unocal deal is something new, not only because it is much bigger and more politically sensitive, but also because CNOOC has, until now, behaved like a commercial, western firm in the bidding process, rather than as an arm of the Chinese government.

Since its flotation in 2001, CNOOC has earned a reputation as one of China's best managed firms. Its shares trade at a premium over those of its larger listed rivals, PetroChina and Sinopec. Mr Fu's market-friendly rhetoric, reflecting his experience of western business (he got a masters degree in California and worked for Phillips, an American oil firm), has contributed to its reputation. "Transparency makes shareholders love you," he says. So does having four respected non-executive directors, including two non-Chinese: Evert Henkes, a former Shell executive, and Kenneth Courtis, vice-chairman of Goldman Sachs in Asia.

Buying Unocal could threaten this hard-won credibility. Analysts and minority investors, who own 30%

of the stock, are concerned. CNOOC is offering 9% more than Chevron. Then there are integration and political risks and a big pile of fresh debt. The Chinese offer is in cash—the shares even of a well-run Chinese firm are not yet acceptable as takeover currency.

It is no surprise that China wants Unocal. The country is thirsty for energy to fuel its booming economy. China is already the world's second-largest oil importer, after America. More even than oil, China wants gas, of which Unocal has lots, but which currently accounts for only 3% of China's energy use.

To correct that imbalance, CNOOC's state-owned, unlisted parent company—which still owns 70.6% of the listed CNOOC—is building up to ten giant liquefied-natural-gas terminals along China's east coast. All that it needs now is the gas. Three-quarters of Unocal's gas reserves (and a quarter of its oil) are in Asia (mostly Indonesia, Thailand and Bangladesh) and may be double previous estimates. This, and the American firm's expertise in deep-water oil-drilling, is what CNOOC, or rather China, wants. Price, therefore, does not matter much. Chevron may raise the stakes by upping its bid, but, ultimately, “if the People's Republic of China wishes to acquire Unocal, it will,” says David Hurd of Deutsche Bank in Hong Kong.

Mr Fu is caught between two imperatives. On the one hand, he is a western-trained manager fighting for the interests of all shareholders. On the other, he is president of CNOOC's state-owned parent and ultimately beholden to Beijing. Pulling off the deal would bring huge political influence and secure his future.

Caught between yin and yang

Hence CNOOC's initial ambivalence towards Unocal. After a tentative first approach last December, the Chinese company almost bid this April, only for Mr Fu to pull back in deference to the concerns of his non-executives. The independent directors then hired their own team of advisers, led by N.M. Rothschild, an investment bank, to judge whether a bid was in the interest of all of the firm's shareholders. Mr Fu insists that it is: “China needs gas. Unocal will allow us to sell more gas to China and grow our company for shareholders.” He plays down the political risks, saying that Unocal's production is equal to less than 1% of American consumption and that, unlike Chevron, CNOOC will preserve local jobs. To maintain financial prudence—Mr Fu's mantra in the past—CNOOC's parent will provide $7 billion in cash, easing the strain of the bid on the listed firm's balance sheet.

While the parent's role raises doubts about the deal's commercial logic, it should protect CNOOC's minority investors. The bulk of the transaction will take place through the listed firm, not (as is common practice in China) its opaque, unaccountable parent. “If our parent buys Unocal, America will think the Chinese government wants it,” says Mr Fu. But “this transparent, commercial way, based on international practice, should be less sensitive for the US government.” Will that really reassure American politicians, given that CNOOC is state-controlled? Mr Fu says that, although his firm is like a state company in ownership, “in management and operations we are commercial.” Perhaps. But with oil and gas prices at record levels, Mr Hu's expensive deal puts the extent to which CNOOC is really a commercially driven firm, with corporate governance able to protect all its shareholders from Chinese political pressure, to the severest of tests.

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Boeing v Airbus

Nose to nose

Jun 23rd 2005 | PARIS
From The Economist print edition

EPA

Why has the trade dispute between the world's two big aircraft-makers suddenly become so bitter?

LIKE Kaiser Wilhelm's army in the summer of 1914, the United States Trade Representative's office is rumbling inexorably down the track to war: it seems too late to stop the conflict that looms. Immediately after America filed its complaint to the World Trade Organisation (WTO) at the end of May about European subsidies to Airbus, the European Union (EU) followed with a counter complaint about federal and state subsidies to Boeing in America. It seems that the Europeans too had been mobilising as the storm clouds gathered last autumn. The Americans accuse Airbus of receiving subsidies worth $17 billion in launch loans alone over the past 35 years. The Europeans counter that Boeing has enjoyed R&D subsidies worth $23 billion in the past 13 years.

The current 30-day pause in proceedings is merely an opening salvo, as each side squabbles about the membership of the panels that will review the respective claims. The European side likes to characterise the postponement of the launch of a new Airbus model (the A350) as a conciliatory gesture to gain time for further direct bilateral negotiations. In fact, the delay is really because of the British government's refusal to be rushed into handing over the lion's share (£379m) of the £600m ($1.1 billion) subsidy Airbus wants. (Britain makes the expensive wings, hence its high share.)

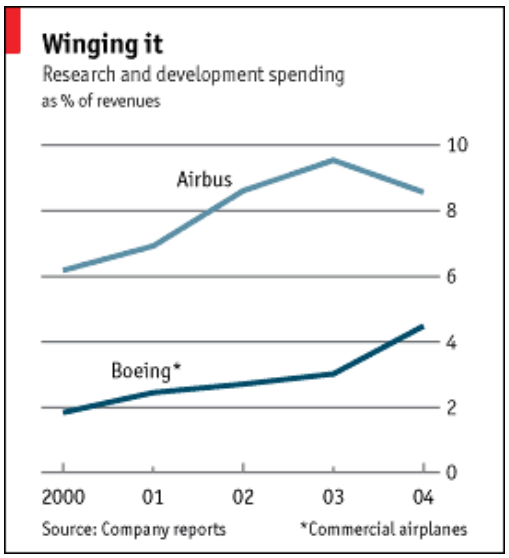
The origins of this long-running dispute lie in the economics of the development and manufacture of large commercial aircraft. Modern planes sell for between $50m and $250m, depending on whether they are 120-seaters or jumbos. Each new model contains huge technical risks. Will it fly as safely and efficiently as the engineers calculate? Can it be built to the required price? A new plane also requires huge upfront R&D spending before the first test flight. The latest Airbus, the A380 double-decker to carry 555 passengers, had cost around $12 billion even before its first test flight a couple of months ago. The new Boeing 787 will probably cost at least $10 billion to develop.

Once production starts, the learning curve is steep and difficult. Each doubling of production generally yields a cut of one-fifth in unit cost per plane. Consequently, it takes production of about 500-600 aircraft before a model starts to earn a profit. That would typically amount to around ten years of production. Total industry demand in good years runs around 700-800 planes but is spread across a wide range from short-haul, single-aisle models to long-range and jumbo aircraft. The combination of these factors explains why the industry has a tendency towards natural monopoly. It also explains why a company such as Boeing, which has enjoyed over two-thirds of the market since the launch of the 747 over 30 years ago, does not rush to bring new models to market—it wants to milk its incumbent

dominance.

This is the background to the re-emergence of a bitter trade dispute that has been around, on and off, since the French and German governments first created the Airbus consortium in 1970. In the early years they poured billions into the project in straightforward production subsidies and debt write-offs, as a fledgling Airbus tried to get aloft and win credibility with the world's airlines.

They did this for several reasons: they wanted to preserve their tiny aircraft industries and thought the only way to do this was by combining forces to create a single European producer (the British and Spanish joined later). The civil aircraft industry is seen by governments as strategic: it helps sustain a military aerospace capability by giving the aircraft producers more volume; it creates large numbers of high-technology, well-paid jobs; and it produces high returns.



The Europeans defended their early subsidies as those appropriate to an “infant industry”. The subsidies were also justified on the grounds that they prevented the Americans, and Boeing in particular, from enjoying a monopoly that was emerging as civil aviation grew dramatically in the 1960s and 1970s. One estimate, quoted in a study of the trade dispute by Britain's Royal Aeronautical Society, claims that the price of big commercial jets (those over 100 seats, as made by Boeing and Airbus) would have been 40% higher today if Boeing had managed to obtain a monopoly. But, as the study's author Keith Hayward acknowledges, the emergence of Airbus stopped that from happening.

It also led, ironically, to the exit of Boeing's two domestic rivals, Lockheed Martin and McDonnell Douglas, from the civil jet market. These two companies accelerated their departure by making disastrous choices to compete head on with “me-too” tri-jets in response to Boeing's game-changing jumbo, just as Airbus was developing the competing idea of a more economical twin-engined widebody (the A300). Interestingly, Airbus's original idea, the twin-engined big plane, is now the core of Boeing's product strategy, while Airbus's hopes are partly pinned on its imitation of the jumbo, its large A380.

The infant-industry justification for European subsidies began to wear thin towards the end of the 1980s as Airbus gradually built market share, setting itself the aim of winning 50% by 2000. Boeing and the American government were convinced that subsidies were allowing Airbus to buy market share on price alone. This was patently not true since Airbus had newer technology and greater production efficiency from about 1996. And yet the subsidies had helped Airbus rapidly develop a competitive product range.

After four years of public sniping, the European Commission and America's trade officials agreed a deal in 1992 that ruled out production subsidies (the British and German governments wanted that too) and limited refundable launch aid to Airbus to 33% of the development cost of a new model. The Europeans agreed that support would go only to projects likely to repay the money within 17 years; and that the interest rate for the first 25% of refundable loans would be at government rates, but the rest would be at one percentage point above that. Furthermore, repayments would be by a royalty on sales (to continue even after full repayment), rather than only at the end of the loan period.

The Americans, for their part, pledged to limit indirect aid to Boeing through Department of Defence and NASA development contracts, to 4% of the company's civil-aircraft turnover. The Europeans agreed to a similar limit on their indirect aid. The preamble to the 1992 deal refers to the aim of reducing launch

aid, but the wording is somewhat ambiguous. The Americans interpreted it, quite reasonably, as meaning this was only a start towards eventual elimination, while the Europeans regarded the deal as validating launch aid within limits. Alan Mulally, chief executive of Boeing Commercial Airplane Group, says, “instead of abolishing launch aid, the Europeans institutionalised it.”

So there was scope for further strife, even after the two sides signed that truce. But the scene was also set for things to get much worse. Barely a year later, the precursor of the WTO (known as GATT) concluded a general agreement on subsidies and countervailing measures. Basically, this prohibited subsidies to specific firms from the public purse. However, it did not deal with the issue of large commercial aircraft—an oversight the Americans came to regret as they eyed Airbus's rampant market-share growth and the firm's plans to expand its widebody product range to challenge, with its A330s and A340s, Boeing's forthcoming 777 models.

Quicker off the chocks

As Harry Stonecipher, former chief executive of Boeing, put it last year, the launch-aid subsidies allowed Airbus to develop five new planes in ten years, while Boeing could afford only one (the 777, before the new 787 got under way). He complained that Airbus could take big bets because launch aid shifted much of the risk to the taxpayer. As Airbus prepared to launch its A380 super-jumbo, Boeing won support from the Clinton administration to go after the Europeans at the WTO, only to have second thoughts about a trade war that might rebound on its sales in Europe.

But once Airbus launched the A380 in 2000 and started to out-sell Boeing, winning more orders year after year and becoming ever more efficient in its manufacturing, the gloves were bound to come off, the more so since America lost a WTO case on tax breaks for export sales of which Boeing was a big beneficiary. After failing to win orders for an advanced middle-sized plane called the Sonic Cruiser and for an enlarged version of the 747, Boeing eventually settled for the 787, an economical aircraft with attractive big windows and pleasantly lower cabin pressure. Then last spring Airbus let it be known that it was developing an instant riposte with a new version of its middle-sized A330, to be called the A350. Boeing attributed this instant ability to challenge its darling to the availability of subsidies, and immediately junked the 1992 accord and declared it was preparing to file suit at the WTO.

Peter Mandelson, the EU's new trade commissioner, at first adopted a conciliatory tone. By January 10th this year both sides had an eight-point framework for bilateral negotiations, while both held off from filing suits at the WTO. By the middle of May, however, the Americans were convinced that negotiations were going nowhere. According to an internal Boeing document, “the [European Commission] (helped by Airbus) has spent the past four months trying to divert attention from its apparent determination to provide additional launch aid for a new Airbus plane by repeating over and over again the list of subsidies it alleges that Boeing receives.” There is indeed some evidence that Mr Mandelson has had his hands firmly tied by the French and German governments, which are unwilling to allow him any scope to trade away their beloved launch aid without being sure of a quid pro quo.

Reuters

Time to trim the flaps?

But a more impartial description of the current stand-off would be that the Americans are demanding the Europeans surrender their biggest card before anyone even sits down at the table. Europeans are prepared to discuss cutting or dropping launch aid only if the Americans will put on the table the subsidies the Europeans allege that Boeing enjoys. Their 14-page counter-suit to the WTO includes a long list, mainly consisting of NASA and Pentagon development contracts, which the Europeans claim confer special advantages on Boeing through preferential access to intellectual-property rights. According to the European camp, this aid is worth $23 billion to Boeing since 1992.

Boeing retorts that even Airbus benefits from fundamental research contracted out to Boeing (and other American aerospace firms) because the results are publicly available and that, in any case, Airbus's parent company EADS enjoys similar spill-over from European defence budgets. However this ignores the fact that the American defence development programmes are not only much larger than most in Europe, but are also cost-plus (ie, the risk is borne by the government customer). In Britain, defence companies such as BAE Systems (which owns one-fifth of Airbus) bear their own development risks and have to write off billions of pounds when things go awry.

In truth, both companies benefit from difficult-to-quantify defence spill-overs, thanks to their involvement in both military and civil aircraft. But this time around the subsidy row is breaking new ground. Both sides are trading accusations about financial assistance given by local governments in places where they have factories. The EU suit, for instance, cites 14 Wichita City Council Ordinances since 1992, allowing Boeing no less than $2.6 billion in tax breaks. There is some irony in the fact that the beneficiary of such breaks in future will be Onex, a Canadian private-equity firm that has bought Boeing's Wichita factory, which produces fuselages for such Boeing planes as its bestselling 737 and will make the nose of the new 787.

Calling a subsidy a subsidy

The Europeans also make much of recent legislation in the state of Washington, which houses Boeing's Seattle factories. The state's governor had amendments tacked on to some other legislation that have the effect of giving Boeing a tax break of $3.2 billion over 20 years in return for agreeing to house the final assembly of a 250-seater airliner in the state. Boeing disingenuously maintains such aid would be available to Airbus if it were itself to manufacture a “250-seater, economical aircraft” in Washington, as specifically described in the legislation. In response, Boeing calculates that Airbus received public investments worth $1.7 billion in facilities in Germany, France, Britain and Spain for the manufacture and assembly of the A380.

In a couple of papers reviewing Boeing's plans for the 787, David Pritchard and Alan MacPherson of the Canada-United States Trade Centre at the State University of New York, Buffalo, conclude that much of Boeing's aid for the 787 is either prohibited or actionable under the WTO rules on subsidies and countervailing measures. They do not concern themselves with aid to Airbus, perhaps because launch aid is so clearly at odds with the rules. After all, Airbus has taken 20% of the market away from Boeing and won the lead on orders for four out of the past five years, as well as beating Boeing on deliveries last year.

The nightmare for America and Europe is that both WTO suits succeed. That is what happened a decade ago when Canada and Brazil pursued each other over subsidies to Bombardier and Embraer, their regional-jet manufacturers. In the event, neither country invoked the huge penalties they could have inflicted on each other, for fear of the damage that would do to their wider mutual trade. But the threat of countervailing import duties being applied to new Airbus and Boeing planes would cast a pall over the aviation industry and could even ignite a disastrous transatlantic trade war.

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Going Japanese

How Japan learned to fly

Jun 23rd 2005
From The Economist print edition

Stealth aid to Boeing has helped Japan to enter the manufacturing business

AMERICANS and Europeans have been quarrelling about subsidies for the manufacture of large commercial aircraft for nearly 40 years. But the quarrel today is much more complicated. Aircraft manufacturing has long been nationalistic, tied heavily to military and strategic interests through defence contracts. Lately though, it has been growing more and more global. Both Boeing and Airbus have built long supply chains reaching deep into each other's heartlands and they share many suppliers—about half of a new Airbus, for instance, is actually built in America.

Meanwhile, Boeing planes are becoming progressively more Japanese as Boeing has broadened its search for subsidies and Japan has been willing to pay in order to get a share of an industry long closed to its manufacturers. The change has been profound. In the 1960s only 2% of the content of Boeing's breadwinner, the 727, was non-American. By the mid-1990s this had grown to 30% in the 777, large parts of which are made in Japan. The latest Boeing model, the 200-300-seater long-haul 787, is the first of a new family of aircraft that represents the company's future in commercial aircraft. At least 70% of it will be built outside America, mostly in Japan.

The aircraft will be made almost entirely of new ultra-light composite materials. This is the biggest technology shift since the wood and doped fabric of the Wright brothers and Red Baron days gave way to riveted aluminium tubes. Yet Boeing is farming out design and production of key parts of the wings to a consortium of Japanese firms on a risk-sharing basis. These are not “build to print” conventional subcontracts of the type used by Boeing over the past 20 years. Rather, Boeing is turning itself into a virtual company, a systems integrator. The 787 will spend only three days going through the final assembly line in Everett just north of Seattle.

The Japanese companies—a consortium led by the heavy industry arms of Mitsubishi, Kawasaki and Fuji—will line up their own supply chain across Asia for the component parts to go into the vast sub-assemblies they will be making. Japan thus has within its grasp an industrial goal that has eluded it for 50 years—to become a major force in aircraft—even as its government successfully encouraged the rise of its automotive and electronics industries.

Why on earth would Boeing hand over the keys to its design locker? The answer is that it thereby reduces its development risks, and that has been its principal counter to the advantages Airbus enjoys through its subsidies.

Japan's role in Boeing's 787 programme is to be financed partly by the Japanese taxpayer. Negotiations between the government and the Japanese Aircraft Development Corporation (JADC) have been going on for a year over the terms of $1.6 billion-worth of launch aid to enable JADC to meet Boeing's needs. This mirrors the launch aid that Airbus is seeking for its rival A350, indeed it amounts to 50% more aid.

As the spat over subsidies intensifies, the Europeans retain the option of filing a suit against the Japanese as a way of getting at Boeing indirectly. That would cast a further shadow over the prospects of the 787. So why not do it? After all, the more work Japan gets in future, the greater the chance it could eventually undercut first Boeing, then the Europeans themselves. Alternatively, the Europeans might cosy up to Japan, and a small, but significant, deal on supersonic technology signed between Japan and France at the Paris Air Show suggested that process has begun. With so much at stake, the Europeans probably want to fight one battle at a time: Japan can wait—Boeing is first in line.

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Investment banking

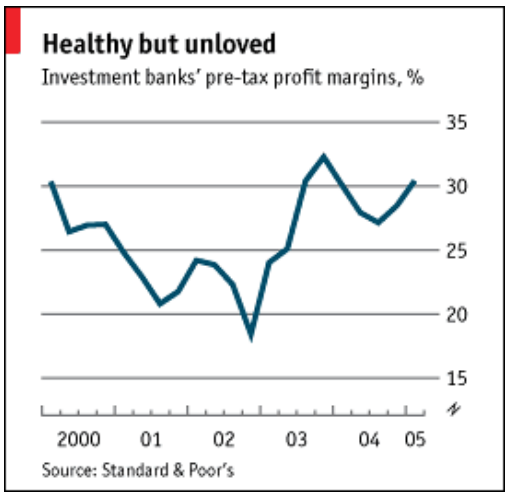
Looking for directions

Jun 23rd 2005 | NEW YORK
From The Economist print edition

Alamy

Wall Street's titans complain that the stockmarket doesn't understand their business. Given the latest results, that's no wonder

YOU might expect that the stockmarket would, if it understood no other industry, be able to fathom investment banking. Yet the heads of Wall Street's biggest firms are no different from the bosses of companies the world over, in complaining that the market consistently undervalues their shares. The Wall Streeters may have a point. Investment banks trade at below 11 times past earnings, a third less than the average listed company. And that is despite pre-tax profit margins that even in 2002, at the depth of the bear market, never dipped below 18% and have subsequently hovered around 30% (see chart). Numbers like that are the mark of a resilient and prosperous industry.



A sense of why the stockmarket views the Street so sceptically can be gleaned from the second-quarter earnings figures now coming out of investment banks. The numbers have been full of surprises, both good and bad. Overall, conditions for the industry have been decent, but not great. Markets have been a

bit more volatile than they were, which can be unsettling but should still be handy for trading profits—the recent difficulties of some hedge funds notwithstanding. Short-term interest rates have continued to rise, meaning that borrowing money, an important cost, has become dearer; but long-term rates have declined, meaning better conditions for underwriting and buy-outs, both important sources of revenue.

With these conditions, it would not have been a shock if most firms had done pretty well. Instead, results have diverged widely, taking analysts by surprise on both sides. The stockmarket likes firms that earn money in predictable ways. Recently, even Wall Street seems to be at a loss to understand itself.

Prominent among the success stories was Bear Stearns. However, in areas in which it is perceived to be particularly strong, notably the trading and issuance of fixed-income securities such as bonds and mortgage-backed notes, profits dropped. It was in other areas where expectations were more modest, in particular equity trading and merger advice, that revenues were sharply up.

Lehman Brothers has been the other star, continuing a long run of good performances stretching back to the 1990s. Yet even Lehman managed a surprise, in revealing that a record 40% of its revenues came from outside America. Lehman's consistently good record has earned it, alone among the leading firms, the likelihood of an upgrade in its credit rating from Standard & Poor's, a rating agency.

In many industries, form like Lehman's would be rewarded by the stockmarket too, but not, it seems, in investment banking: Lehman's shares are priced much like its competitors'. An indicator of the market's difficulty in reading investment banks is, perhaps, that Lehman is one of the few companies whose biggest shareholders include one large mutual fund that invests only in growth stocks and another that invests only in shares that look cheap.

Oddly, the big investment bank whose price, relative to its earnings, is highest is Morgan Stanley, on the face of it the most troubled firm on the Street and arguably its most disappointing performer. On June 13th it said that its earnings would be poor. On June 22nd it reported a drop in profits of 24%, compared with the second quarter of 2004, even worse than it had led the market to expect. Revenues from trading and underwriting were down, and its retail operations are listing. Support for Morgan Stanley's shares must come from either the hope of better management or the daily rumours of a takeover.

Goldman Sachs, often thought of as the securities industry's leading light, also had a disappointing second quarter. Its earnings release raised at least as many questions as it answered. Investment-banking revenue was down a bit, although the firm said that business conditions were now improving. Worse, though, was a steep decline in revenue from trading and investment. Goldman Sachs explained the decline, a little elliptically, by saying that during the quarter it had fewer clients doing fewer things. David Hendler, a senior analyst with CreditSights, speculates that its proprietary trading desk may have been so weighed down with various commitments that the firm could not react to improving market conditions in May, but this is just a guess. It is hard to work out where Goldman makes its money, and thus to place a value on it.

It is not just the variation and unpredictability of performance that makes investment banks hard to read. The industry is under continual legal attack. Several banks have recently shelled out billions to settle investors' suits related to the Enron affair, and more are expected to do so. The latest assault consists of class-action suits filed against Goldman and Lazard, another investment bank, concerning Lazard's initial public offering in May.

The shares were priced at $25 each, producing a total stockmarket valuation just shy of $1 billion. Investors had reason to be cautious. The financial structure of the deal was unusually complex. Pay for Lazard's bankers was significantly higher than at other investment banks. Internally, the firm was enmeshed in outright warfare between its long-time controlling shareholder, Michel David-Weill, and its current chief executive, Bruce Wasserstein. Whereas many share offerings raise money to pay for reinvestment, much of the cash from this one was needed to pay Mr David-Weill to go away. And it is a fact of equity underwriting that every dollar taken off the offering price is a dollar taken away from the seller. It is the art, and responsibility, of the underwriter to set a price that attracts buyers, yet gives the seller the fullest possible haul.

Within days of the flotation on May 5th, the price of Lazard shares had fallen to $21. Despite a bounce, it has yet to achieve the level at which the shares were sold. In response, no fewer than five law firms have filed shareholder suits against Goldman and Lazard since June 16th.

A chief contention of the plaintiffs is that both firms knew Lazard should have been valued below $22

and engaged in a complex manipulation to push it briefly upwards. Goldman unequivocally denies the charge of manipulation. Perhaps its strongest defence would be to dismiss the notion that anyone could possibly know what an investment bank was worth.

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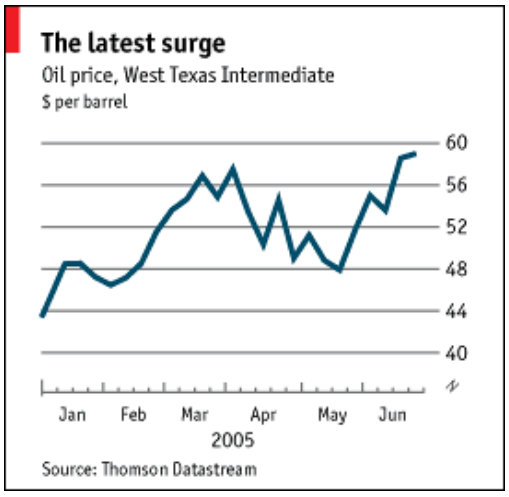
Oil prices

Hotting up again

Jun 23rd 2005
From The Economist print edition

Can anything cool the oil market?



THE verdict of experts at the Centre for Global Energy Studies, a London think-tank, is pretty damning. "OPEC", it declares, "has lost credibility as a guarantor of stable oil prices." Back in the spring, the influence of OPEC—the Organisation of Petroleum Exporting Countries—looked plain, as Saudi Arabia, the cartel's kingpin, said that OECD countries' stocks should be allowed to build up. Supply increased, inventories swelled, and prices dropped—to $48 a barrel a month or so ago. Yet this week the price of West Texas Intermediate (WTI), a benchmark crude, was at a new record, flirting with $60.

Why, then, have prices shot up in the past few weeks? There is no shortage of crude oil: the market seems well supplied for now. Look ahead a few years, say optimists, and there is little cause to worry. A provocative new report by Cambridge Energy Research Associates, a consulting firm, even says that there could be a glut. Having carried out a field-by-field assessment of investment already paid for and coming online, its boffins conclude that global production capacity may rise by 16m barrels per day, from roughly 85m now, by 2010.

Today's prices are probably explained by a combination of the cartel's greed, bottlenecks in the refining system and red-hot demand. OPEC's members are all pumping oil as fast as they can. Only Saudi Arabia has any spare capacity left. This leaves the world market with no safety net, making oil traders jittery and causing them to demand a risk premium.

At the cartel's most recent meeting, in Vienna last week, ministers tried to soothe such fears. They raised output quotas by 500,000 barrels per day immediately and promised a further, similar increase if prices remained above recent levels. Far from reassuring markets, this created more worries. The quota rise was seen, correctly, as a mere public-relations exercise: because members were already producing more than they had previously agreed, it added no new oil to the market.

Indeed, OPEC's promise of a second increase in quotas if prices rise further has been taken to mean that the cartel now accepts a new upper bound for the target price of its basket of heavy crudes (which is a little lower than that of WTI). This is not the $28 or so discussed months ago, but $50-plus. The cartel may thus be testing consumers' acceptance of high prices.

A second factor behind the recent price hikes is bottlenecks in the global refining system. Those big inventories encouraged by the cartel have been processed by refiners, who have been enjoying high profit margins. There are now large stocks of refined products in OECD countries. However, the existence of these stocks is not dragging crude prices down. The reason is that the types of crude available from OPEC members tend to be heavy, sulphurous grades that are complicated or costly to process. Meanwhile, the global market is demanding ever more clean diesel fuels and low-sulphur petrol.

Nevertheless, talk that refining bottlenecks will keep pushing oil prices higher seems overdone. In time, market forces will spur refiners to make the necessary investments to upgrade their equipment. Analysts at Goldman Sachs suspect that many refiners used their spring maintenance cycle to upgrade their equipment in order to handle heavier, dirtier crudes. Refiners will have done well to use their margins while they could: eyeing those profits, Saudi Arabia has trimmed the discount, relative to WTI, at which it sells its crude oil to refiners.

In the end, how long today's rally lasts could depend on the final factor pushing up prices: demand. Chinese oil consumption grew by perhaps 15% last year. Although that rate has not been matched in 2005, the world as a whole has continued to guzzle oil.

At some point, of course, high prices will clobber demand and encourage efficiency, fuel switching and so on. Will that happen soon? Probably not. In a new report, Douglas Terreson of Morgan Stanley estimates that the world economy would need to see sustained prices of $85 a barrel before the current robust trend in oil consumption is derailed—and with it, the world economy. And despite the recent run-up, $85 is still far off.

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Sugar subsidies

Beet a retreat

Jun 23rd 2005
From The Economist print edition

The European Union scales down its sugar subsidies

EPA

They'll just have to lump it

IT IS twice as costly to produce sugar from beets, in the temperate climes where these crops take root, than to make it from cane, which grows tall, year-round, in the tropics. And yet the European Union is one of the world's biggest exporters of sugar.

This is possible only because Europe's sugar farmers are as adept at extracting favours from Brussels as they are at extracting sucrose from beet. The EU is obliged to buy sugar from its beet growers at €632 ($768) a tonne, almost three times the world price. Such high prices attract imports from overseas, and encourage overproduction and underconsumption at home. The EU deters imports by raising tariffs, and it clears its sugar mountains by subsidising exports. EU producers have shipped more than 3m tonnes annually in recent years, accounting for about 10% of world exports.

This sugar regime, untouched since 1968, is now ripe for reform. Despite beet growers' angry opposition, the European Commission on June 22nd unveiled its proposals for a radical overhaul. By 2009, the price it sets for white sugar will be cut by 39%. In partial compensation for their loss, farmers will be given a handout that rewards them for their “respect” for the land, not their output of sugar.

The commission also proposes to pay sugar factories to go out of business. If they quit in the first year of the new regime, they will receive €730 for each tonne of sugar they used to produce. This amount falls in each subsequent year. If factories wait until the fifth year to throw in the towel, they will get nothing.

The proposals must wait until November to secure the approval of ministers, which may not be straightfoward. “The easy option would be to sit on my hands,” admitted Mariann Fischer Boel, the EU's agriculture commissioner. But that is not really an option at all. The World Trade Organisation recently ruled that the EU's subsidised exports of sugar breached legal limits. One way or another, Europe must scale down its sugar industry, either through a painful process of attrition or by inviting the least profitable producers to make a prompt and graceful exit.

Michael Mann, spokesman for Ms Fischer Boel, hopes that America and Japan, both generous sugar daddies in their own right, will now follow the EU's example. The stakes are quite high. In 1999, Brent Borrell, of the Centre for International Economics, an Australian research institution, and David Pearce, now of University College, London, calculated that unhindered and unsubsidised trade in sugar would improve the world's lot by the equivalent of $4.7 billion each year. And according to Donald Mitchell, of the World Bank, net imports by Japan, Europe, America and Indonesia would increase by 15m tonnes a year, creating almost 1m jobs in poor countries. In western Europe, sugar prices would fall by 40%.

But the commission's sugar reform will leave a sour taste in the mouth of 46 African, Caribbean and Pacific-island nations that now enjoy privileged access to the EU's sheltered market. Under the current rules, these countries can sell about 1.3m tonnes of sugar, at a price of €524 a tonne. Under the commission's proposals, this price is due to fall to €303, depriving them of revenues worth about €287m. The commission has earmarked €40m in 2006 to help some of these countries adapt, and may give more once its budget is settled for 2007 and beyond. But this is scant compensation for their loss.

Mr Mitchell reports that the beet industry got started in Europe in the early 1800s only because difficulties in the colonies disrupted the supply of cane sugar. The battle between beet and cane has raged ever since. The Africans, the Caribbean nations and the Pacific islanders are caught in the middle, but the world still has lots to gain from beet's steady retreat.

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Derivatives

Double or quits

Jun 23rd 2005
From The Economist print edition

After failing in Treasuries, Eurex's American venture changes course

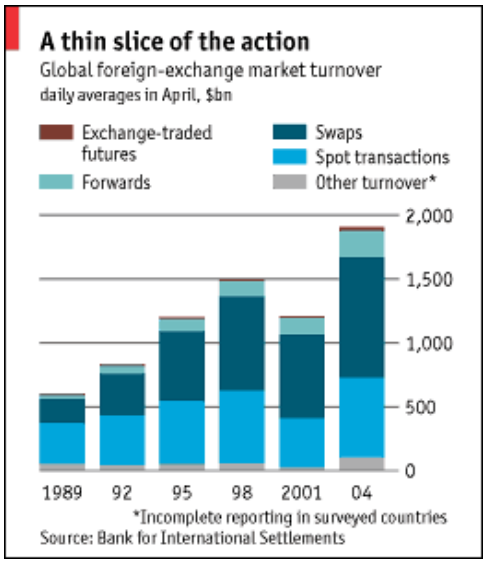
THEY work hard and play hard in the derivatives business. Traders will happily attend your swish parties, drink lots of free cocktails and polish off your hors d'oeuvres. But that's not enough to win their loyalty. Not in Chicago, anyway.

Such thoughts may have crossed the mind of Rudolf Ferscha, the boss of Eurex, a German-Swiss derivatives-exchange company. Next week he will have to put on a brave face at an annual conference of the industry's movers and shakers. On June 16th Eurex US, the American arm of Mr Ferscha's company, admitted defeat in its 16-month battle to wrest the market in American Treasury futures from the Chicago Board of Trade (CBOT). This was more bad news for Deutsche Börse, Eurex's German part-owner, whose chairman and chief executive were recently ousted by shareholders, notably hedge funds that disapproved of its strategy. Eager to change the subject, Mr Ferscha said the same day that Eurex US would begin trading foreign-exchange futures in September. But that move pits it against another formidable opponent, the Chicago Mercantile Exchange (CME).

Mr Ferscha, a towering Austrian with a fondness for playing the piano, brought Eurex to Chicago with both style and substance. Eurex US spent lavishly on public relations—but also offered low trading fees and all-electronic trading. Unfortunately for the Europeans, the Chicagoans fought back fiercely. Eurex US accuses the CBOT of playing dirty. It has filed an antitrust suit against both the CBOT and the CME. The Chicago pair, bitter rivals in the past, set up a joint clearing operation in the face of the Europeans' challenge.

Some might think that Eurex US is just as brave to take on the foreign-exchange market as it was to tackle Treasuries. Granted, the global foreign-exchange market is booming: average daily turnover—totting up spot and forward trades, swaps and futures—is $1.9 trillion, estimates the Bank for International Settlements (see chart). However, most trades do not happen on exchanges but “over the counter”, in the jargon. A huge amount goes on between banks. Exchange-traded futures account for less than 2% of the total, and the CME handles 95% of this.

Eurex US sees an opportunity nonetheless. It plans to attack with a 23-hour trading platform, lower fees and (in the hope of luring banks) larger contracts than the CME. This week Mr Ferscha claimed that several big banks had already made commitments to trade with Eurex US.



Others doubt that an exchange can prise much business away from the over-the-counter market. “For people with real liquidity needs, it will be a long, long time before you can disintermediate the relationship between banks and customers,” says Lars Christensen, of Saxo Bank, a Danish provider of online investment-banking services. His bank has done foreign-exchange business with the CME, but he contends that “when the market really moves, that's not where you want to be”.

Meanwhile, the CME says it welcomes competition. It has already cut its fees in readiness for Eurex US's change of strategy. And should the Europeans eventually go for what many think is the real prize in Chicago—the CME's Eurodollar contracts—they can expect an even fiercer battle.

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Auditing

Crime and punishment

Jun 23rd 2005 | NEW YORK
From The Economist print edition

Can the government afford to indict one of the Big Four accounting firms?

IT WAS the last thing that the accounting industry needed, as it tries to rebuild its reputation after the scandals at Enron and elsewhere. Last week KPMG, one of the "Big Four" accounting firms that dominate auditing worldwide, said that it was negotiating with America's Department of Justice. It hopes to avoid a criminal indictment over its marketing of "abusive" tax shelters between 1996 and 2002.

The question hanging over KPMG is not whether it is guilty, but what its punishment will be. The firm has already put up its hands, taking "full responsibility for the unlawful conduct" by some partners, since sacked, as well as expressing deep "regret" for its tax trickery. An indictment would amount to a death sentence, as it did for Arthur Andersen, whose demise reduced the former Big Five by one. After Andersen was charged over its auditing of Enron, its international network of accountants and its client base fell apart. The recent reversal by America's Supreme Court of its conviction in 2002 for obstructing justice came far too late.

KPMG was not alone in selling tax advice to clients. An investigation into tax sheltering launched in around 2000 by the Internal Revenue Service (IRS) unearthed allegedly improper schemes at the other three firms too. However, KPMG chose to defend its tax work more aggressively than its peers did. For instance, it refused to hand over documents to the IRS in 2002, claiming attorney-client privilege. When a court reviewed its claims later that year, it came to the "inescapable conclusion" that KPMG had taken steps during the IRS investigation "designed to hide its tax shelter activities". These tactics may have left it open to a charge of obstructing justice.

Still, most believe an indictment is unlikely. Unlike Andersen, KPMG has not only confessed its guilt, albeit tardily, but has sacked dozens of partners in the tax-services division, reshuffled its top management team and discontinued the marketing of the tax services "in question".

More important, many experts both inside and outside government now view the prosecution of Andersen as a mistake that worsened the concentration of the audit industry. "KPMG is DOI—dead on indictment," says Rick Antle of Yale. Boards would be loth to retain an indicted auditor, especially after seeing former directors of WorldCom and Enron pay millions of dollars out of their own pockets to settle investors' lawsuits stemming from accounting scandals. Holding on to employees, particularly abroad, would be as difficult as keeping clients.

In the short term, KPMG's collapse would set off a scramble among companies looking for a new auditor. The Securities and Exchange Commission is said to be considering relaxing rules that make it difficult for a company to switch auditors should one of the Big Four fail.

The longer-term consequences are more worrying still. Already, regulators worry that there are too few auditors for the industry to be competitive. The Big Four dominate the audit of big, listed multinational companies because second-tier firms lack the capacity and the international networks needed for the job. In certain industries, such as oil and gas, concentration is especially acute, with only two or three auditors ruling the market.

Many companies already find it difficult to switch auditors because they use one or two rival Big Four firms, in addition to their auditor, for other work, such as valuation or advice on internal controls. This is because newish rules, implemented in the wake of the scandals at Enron and other companies, ban auditors from offering a wide range of non-audit services. An auditing industry based on a Big Three would be "intolerably restrictive", according to Mark Cheffers, of Audit Analytics, a research firm.

Could the concentration of the industry be tackled directly, by breaking up the Big Four or by

encouraging smaller firms to merge? Not easily. A break-up would be messy. More important, scale matters in the audit of large, multinational companies, which is why the industry consolidated into five big firms in the first place. It is unclear that a bigger crop of smaller firms would audit companies' books any better.

Mergers among second-tier firms would take time. They might make little difference, given the vast gap in size between KPMG, the smallest of the Big Four, and those below. In any case, most smaller players are not keen on bulking up. Their niche of auditing the thousands of public companies below the first rank is lucrative and does not demand a huge international network. And the possible losses from litigation are manageable.

The likelihood is, therefore, that the government will not risk further concentration. Nor will it try to restructure the industry. Instead, it will look for a way to punish KPMG short of an indictment. This would not, however, end KPMG's worries. Its admission of guilt could make it hard for the firm to fight off private lawsuits from those that bought its now-vilified tax shelters. A deferred prosecution agreement or other restrictive punishment could still damage KPMG's reputation enough to cost it clients and staff.

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American bank regulation

Spitzer's trials

Jun 23rd 2005 | NEW YORK
From The Economist print edition

The attorney-general of New York encounters rare resistance

Reuters

Back off, say the banks

IN PURSUING perceived wrongdoing in America's investment banks, mutual funds and insurance companies, Eliot Spitzer, New York's attorney-general, has generally used the same *modus operandi*: he begins with a scathing accusation, follows up with negotiations and emerges with a financial settlement. There are signs that this method has its limits. For the past few months Mr Spitzer has been looking into what he thinks are suspiciously high interest rates charged by several big banks to mortgage borrowers from racial minorities. A group of these banks and, remarkably, their main regulator, the Office of the Comptroller of the Currency (OCC), are telling Mr Spitzer to back off.

On June 17th, Mr Spitzer expressed outrage at legal efforts by the OCC and several banks, including HSBC, Wells Fargo and J.P. Morgan Chase, to block his investigation. Never one to spare fellow regulators at the best of times, he described the OCC's action as “shameful” and “unconscionable”. The banks and the OCC, however, stood firm.

Rather than bow to Mr Spitzer, they took him to court, seeking an injunction halting his inquiry. On June 20th, in a convoluted decision, Sidney Stein, a federal district judge, declined to stop Mr Spitzer but did the next best thing: threatening to stop the inquiry should the attorney-general issue subpoenas demanding information. These had been widely expected.

The full case on the legitimacy of Mr Spitzer's investigation will be decided in July. He has his work cut out. Banks in America can choose to be “national”, and be overseen by the OCC, or to be registered and regulated at state level. The Comptroller's oversight of national banks, with “sole visitorial authority”—ie, exclusive powers of inspection—was established by Abraham Lincoln in 1864, in an effort to create a nationwide financial system in a country riven by civil war. This authority has since been reaffirmed several times by legal authorities from the Supreme Court downwards.

Mr Spitzer will be hard pushed to prove that in this instance his services are needed. His past investigations have been sparked by quiet tips from the financial-services industry. This probe, however, was set off by the publication by all banks in March of data on the race of high-interest borrowers, as required by a new amendment to an old law. As long ago as September, Julie Williams, then the OCC's chief in-house lawyer, had put the banks on public notice that the regulator would treat the new information seriously.

The banks are understandably keen to see Mr Spitzer off. Partly, this is because none wants to stand accused of racial discrimination. Just as important is the thought that if Mr Spitzer can demand records and dictate standards, so can every other state attorney-general across the country. The OCC is no doubt protecting its turf, but it also has a legitimate concern about regulatory chaos.

Regulators who have tussled with Mr Spitzer in the past have usually come out badly bruised, after choosing the course of reason over litigation. Mr Spitzer, too, has preferred to keep out of court, with one notable exception so far: his prosecution of a minor figure in America's mutual-fund scandals. The case was concluded on June 9th, when a jury acquitted Theodore Sihpol on 29 out of 33 counts, leaving the other four undecided. Perhaps the banks, and their regulator, think Mr Spitzer's own judgment day is at hand.

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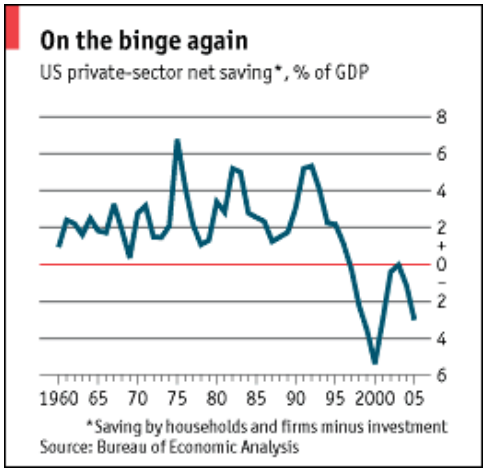
America's economy

Unfinished business

Jun 23rd 2005
From The Economist print edition

American private-sector borrowing is heading back into uncharted territory



IN THE late 1990s *The Economist*'s favourite gauge of America's bubble economy was the private sector's financial deficit (also known as private-sector net saving). This is the combined saving of households and firms minus their investment, and it nicely summed up why we believed America's boom was unsustainable. For almost four decades from 1960, private-sector net saving was positive every year: households' saving always exceeded firms' financial needs. But in the late 1990s, the private sector suddenly lurched into deficit, reaching 5% of GDP in 2000, as households and firms went on a borrowing and spending spree (see chart).

Analysis by the Bank for International Settlements has shown that whenever a country's private-sector net saving swung sharply into deficit in the past, it was almost always followed by a deep economic downturn as the private sector was eventually forced to slash spending, reduce debts and move back into surplus. America, however, escaped with a mild recession, thanks to a generous easing of monetary and fiscal policy. After share prices began to fall in 2000, the private-sector financial deficit did narrow and was almost eliminated by 2003, but the private sector never returned to surplus. Firms slashed spending, but households continued to binge almost as if nothing had happened.

So it is worrying that the private sector's combined net saving is now moving back deeper into deficit, hitting 3% of GDP in the first quarter of this year, almost as much as in 1999. But the mix is different: unlike then, America's corporate sector is now a net saver, investing less than it earns in profits, while households are borrowing more.

This is extremely odd. Usually, in a balanced economy households as a group have been savers, while firms borrow to invest, and thereby boost future output and income. As net borrowers, American households can bring forward spending from the future. The snag is that by consuming ever more jam today, rather than saving and investing, America may be left with only dried bread tomorrow. Keep watching this chart.

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Economics focus

Precisely wrong

Jun 23rd 2005
From The Economist print edition

China's currency may not be as cheap as is commonly believed

FOR a decade, China's currency, the yuan, has been pegged to the American dollar at a rate of 8.28 yuan per greenback. Quite a lot of people—most vocally, some American politicians—think that the yuan is enormously undervalued, so that Chinese exports have an "unfair" price advantage in global markets. Earlier this year, a bill was introduced into Congress that threatens to impose a tariff of 27.5% on Chinese goods unless the yuan is revalued by the same amount. The Senate finance committee was due to hold hearings on the currency on June 23rd. If the figure of 27.5% sounds too precise to be believed, that's because it is: it is simply the mid-point of a range of estimates of undervaluation (15-40%) of which the bill's sponsors were aware. Estimating a fair value of the yuan is a dauntingly tricky business.

Usually, three pieces of evidence are offered to support the argument that the yuan is far too cheap. First, China has large trade and current-account surpluses. Second, the yuan's trade-weighted exchange rate has declined sharply since the dollar started to drop in 2002. And third, China's foreign-exchange reserves have surged in the past couple of years.

All this may suggest that the Chinese authorities have held the value of the yuan below its market rate. None of it, though, proves that the currency is unfairly cheap. On the first point, although China runs a large trade surplus with America, its total surplus is much smaller because it runs deficits with other countries. In any case, trade does not have to be perfectly balanced to be fair; a surplus may simply reflect differences in national saving and investment rates. On the second point, so what if the yuan's trade-weighted value has fallen since 2002? It rose—and more markedly, at that—between 1994 and 1998. And last, the build-up of reserves is not proof of unfair currency intervention, because much of it is the consequence of flows into China of speculative money betting on a revaluation.

For any discussion of the "fair" value of a currency, that value first has to be defined. The oldest theory for doing this is purchasing-power parity (PPP): the idea that, in the long run, exchange rates should equalise the prices in any two countries of a common basket of tradable goods and services. *The Economist*'s Big Mac index is a crude estimate of how far market exchange rates differ from PPP. Our latest index shows that a Big Mac costs 59% less in China than in America—ie, that the yuan is 59% undervalued against the dollar. More sophisticated estimates of PPP, based on traded goods, imply a smaller figure of around 40%.

A second approach is to estimate the fundamental equilibrium exchange rate (FEER). This is the rate consistent with both external balance (meaning a sustainable current-account balance) and internal balance (ie, full employment with low inflation). Working this out requires some idea of China's sustainable current-account balance. Many economists argue that because China has a relatively high return on capital, it should be a net importer of capital—ie, it should run a current-account deficit, not a surplus as it does now. A study by Virginie Coudert and Cécile Couharde, published earlier this year by CEPII, a French international economics institute, estimates that, if China is assumed to have a sustainable current-account deficit of 1.5% of GDP, then the yuan is 44% undervalued against the dollar. A study last year, by Morris Goldstein, of the Institute for International Economics, in Washington, DC, which uses a similar method, suggested an undervaluation of 15-25%.

Hold on: what about internal balance? A problem with many FEER studies, says Stephen Jen, an economist at Morgan Stanley, is that they assume that China is close to internal balance. That is hard to square with 400m underemployed rural workers waiting to shift into industry. Even if external balance requires a big revaluation, the internal-balance criterion may partially offset this, because a lower exchange rate would help to bring underemployed resources into use. And there is another flaw in the FEER studies. The claim that China should be running a current-account deficit assumes that net capital

inflows will continue. But if China liberalised capital flows, these could be reversed as firms and households invested abroad in order to diversify their assets. The sustainable current-account balance might then be a surplus, not a deficit.

Beneath the froth

More fundamentally, Mr Jen is unhappy about defining a currency's fair value as that corresponding to a “sustainable” current-account balance. That is a less useful guide in a world of increasingly mobile capital. He prefers a third method, known as the behavioural equilibrium exchange rate (BEER). Under this method, economists establish which economic variables seem to have determined an exchange rate in the past (as well as having some theoretical basis), and then plug in the current values of those variables to estimate the equilibrium rate.

Econometric tests imply that the most important determinants of the yuan's real exchange rate have been China's productivity growth and budget balances relative to other countries', and its net foreign assets. Using this model, Mr Jen finds that the yuan is currently only 7% undervalued against the dollar. Economists at Goldman Sachs, using a similar approach, reach a similar conclusion: the yuan is 10% too cheap.

Using a range of yardsticks, the International Monetary Fund reckons, like the BEER studies, that it is hard to find strong evidence that the yuan is much undervalued. The uncertainty about fair value explains why the IMF and America's Treasury prefer to say that the yuan needs to become more “flexible” than to call for revaluation outright. It is certainly in China's long-term interest to make its exchange rate more flexible. But calls for a revaluation of 27.5% rest on flimsy foundations. The economics of exchange rates are rarely so simple.

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The cosmic neutrino background

Ripples in the sands of time

Jun 23rd 2005
From The Economist print edition

Cosmologists find hints of an elusive relic of the universe's beginning

CONTRARY to popular opinion, empty space is not actually empty—it positively buzzes with subatomic particles. Many of these are photons, the particles of which electromagnetic radiation (light, microwaves, radio waves and so on) is composed. And most of those photons are part of a relic known as the cosmic microwave background (CMB).

The CMB is made up of photons that began their journey 300,000 years after the Big Bang that marks the beginning of the universe. By analysing ripples imprinted on the CMB, cosmologists can see a picture of the universe as it then was. This has allowed them to infer its shape, and what sorts of matter and energy populated it, with great precision.

Nevertheless, 300,000 years is not exactly an eyeblink, even in cosmological terms. What cosmologists would really like to know is the nature of the universe just a second or two after its beginning. And it now seems as if they are tantalisingly close to getting a glimpse of this, by following the goings-on of a second sort of particle that permeates otherwise empty space—the neutrino.

Standard cosmological models predict that neutrinos, a type of elementary particle with no electric charge and very little mass, were created in large numbers in the Big Bang. Cosmologists therefore have good reason to believe that relic neutrinos permeate today's universe, forming a cosmic neutrino background (CNB) that parallels the CMB. Any ripples in this background would carry information about the universe as it was an instant after the moment of creation.

Neutrinos, however, are extremely hard to detect, so looking for these ripples directly does not seem feasible. But it might be possible to see them indirectly. And on June 15th, Roberto Trotta of Oxford University and Alessandro Melchiorri of the University of Rome, La Sapienza, announced that they had done just that.

Background information

In its infancy, the universe was a hot, dense ball of energy and elementary particles. The different types of particles in it interacted with each other through the fundamental forces of nature, thus maintaining a

sort of equilibrium. As the universe expanded and cooled, however, it became more and more difficult to maintain this equilibrium. If the universe was expanding more quickly than a particular type of particle was able to interact with the other types, that particular type of particle would lose touch with the rest. Its distribution in the universe would then reflect the moment that this loss of touch happened.

Neutrinos interact with other particles through what is known as the weak nuclear force. As its name implies, this force is indeed feeble. Consequently, neutrinos fell out of the ranks early on. A mere one or two seconds after the Big Bang they were running away from one another so quickly that the weak force could not keep them in touch with the rest of the universe. Once this happened, they went merrily on their way, streaming through space for ever afterwards. These relic neutrinos form the neutrino background.

It is the weakness of the weak nuclear force that makes neutrinos so hard to detect individually, even today. (Indeed, in the time that it takes you to read this article, around 10 million billion of them will have passed directly through your body without causing any effect.) But they also interact via the force of gravity, and *en masse* that interaction could be detectable. This is what Dr Trotta and Dr Melchiorri have focused on. Their paper, which will be published in *Physical Review Letters*, reports what they believe is the gravitational effect of the CNB on the CMB.

The CMB was formed at the point, 300,000 years after the beginning, when the universe was cool enough for atoms of hydrogen and helium to form. The universe's primordial photons, which had previously been scattering chaotically off the electrically charged protons, electrons and alpha particles now imprisoned in the newly formed atoms, were thereby set free. The microwave background has been measured with exquisite precision by satellite and balloon-borne experiments.

In 1995 Wayne Hu, a physicist who now works at the University of Chicago, speculated that gravitational effects caused by fluctuations in the neutrino background might be visible in the much more easily detectable fluctuations in the microwave background. They might also be visible in the way that galaxies are distributed, since that distribution, too, reflects conditions early on.

Using a sophisticated computer model of the early universe, Dr Trotta and Dr Melchiorri have now put his idea to the test. They did so by varying the model's parameters—particularly the amount of ripple in the neutrino background—and comparing the outcome with data on the microwave background and the large-scale distribution of galaxies. They found, as they had hoped, that the model universes which most resembled the real one were those in which the CNB most resembled what cosmologists predict that it should look like. The signature of the CNB does, in other words, appear to be there.

At the moment, Dr Trotta and Dr Melchiorri have done little more than prove the point. But that could change quite fast. With better CMB data from new satellites, this approach should allow cosmologists to decide which, if any, of the various exotic theories about the very early universe is actually true. For instance, they have recently come to believe that the universe is dominated by a mysterious phenomenon that they have dubbed “dark energy”. If neutrinos interacted with this dark energy a few seconds after the Big Bang, it might have produced a detectable effect on the ripples in the neutrino background. These would give clues about what it really is.

That alone would be a prize worth having. But besides any scientific importance, the idea of seeing a snapshot of the universe not merely as an infant, but as the cosmological equivalent of a newly fertilised egg, has a glory all of its own.

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Combating cancer

Networking

Jun 23rd 2005
From The Economist print edition

Picking the best treatments for cancer patients

WHILE particle physics can be esoteric, its practitioners are keen to show it has practical applications. They invented the world wide web. They also contributed to a number of advances in medicine, among them positron-emission tomography, a body-scanning technique. Now, as if to strengthen the case, a group of particle physicists led by Robin Marshall of the University of Manchester, in Britain, has applied its knowledge of information technology to show how computer programs known as neural networks can help doctors to choose the best treatments for people with cancer.

Unlike a conventional computer, which takes data, processes it using an algorithm and generates a definite answer, a neural network learns to create a range of answers from a range of inputs. To do this, it is "taught" by being fed a series of training inputs and then told what the answer should be in each case. The network adjusts the weighting of its internal connections to try to retain the correct matches as far as possible. Once the teaching process is complete, the network can be used to calculate answers from new inputs.

Like many in his field, Dr Marshall uses neural networks to discard the huge amounts of boring data produced in particle colliders and to identify the interesting events. The network learns to associate a particular range of inputs with interesting collisions and to ditch the rest. He has now turned this expertise to the medical field, following a chance meeting with Sir Alfred Cuschieri, an oncologist at Ninewells Hospital in Dundee.

Ninewells has detailed records on thousands of patients with colorectal cancer. These records contain a wide range of information such as each patient's age, sex, type of treatment, size of tumour and eventual fate. Dr Marshall realised that a neural network could be trained with this information to calculate the survival chances of other people with the same condition. The machine would learn to associate certain ranges of patient profiles with particular survival probabilities.

Dr Marshall and Sir Alfred, together with some colleagues from Manchester and Dundee universities, selected those records that contained enough data to create a detailed profile of a patient at the beginning of his treatment, and to follow his progress over the subsequent five years. They then used 1,558 of these records to train a neural network. In each case, the input was 16 pieces of data that defined the state of the patient. The output (ie, what the network was trying to learn to predict) was the patient's fate—in other words, whether he died over the course of the five years and, if so, when.

The researchers, who will publish their work in a forthcoming issue of *Concurrency and Computation: Practice and Experience*, then tested the trained network by using the same 16 parameters from each of the remaining 1,220 records as the input, while withholding information about the survival of the patient. They found that, in 90% of cases, the time at which the neural network predicted that a patient's chances of survival would fall below 40% was within three months of the actual time of death of that patient.

According to Sir Alfred, this system is ideally suited to predicting the survival chances of individuals. He says that the statistical techniques currently used by doctors to calculate a person's chances of surviving a disease such as cancer are a blunt instrument. By contrast, the neural network created at Manchester enables them to give individual prognoses, so they do not have to rely on crudely defined average chances of survival.

Once the project's researchers have verified the reliability of their neural network, they intend to make it accessible over the internet. Doctors will be able to enter their patients' parameters and generate prognoses. More importantly, they will be able to compare the effects of different treatments by varying

the relevant inputs.

The researchers also believe that their system could be applied to the treatment of a variety of other chronic disorders, such as heart disease and diabetes. That would create further evidence that particle physicists do live in the real world, at least some of the time.

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Simian economics

Monkey business-sense

Jun 23rd 2005
From The Economist print edition

Monkeys show the same "irrational" aversion to risks as humans

ECONOMISTS often like to speak of *Homo economicus*—rational economic man. In practice, human economic behaviour is not quite as rational as the relentless logic of theoretical economics suggests it ought to be. When buying things in a straight exchange of money for goods, people often respond to changes in price in exactly the way that theoretical economics predicts. But when faced with an exchange whose outcome is predictable only on average, most people prefer to avoid the risk of making a loss than to take the chance of making a gain in circumstances when the average expected outcome of the two actions would be the same.

There has been a lot of discussion about this discrepancy in the economic literature—in particular, about whether it is the product of cultural experience or is a reflection of a deeper biological phenomenon. So Keith Chen, of the Yale School of Management, and his colleagues decided to investigate its evolutionary past. They reasoned that if they could find similar behaviour in another species of primate (none of which has yet invented a cash economy) this would suggest that loss-aversion evolved in a common ancestor. They chose the capuchin monkey, *Cebus apella*, a South American species often used for behavioural experiments.

First, the researchers had to introduce their monkeys to the idea of a cash economy. They did this by giving them small metal discs while showing them food. The monkeys quickly learned that humans valued these inedible discs so much that they were willing to trade them for scrumptious pieces of apple, grapes and jelly.

Preliminary experiments established the amount of apple that was valued as much as either a grape or a cube of jelly, and set the price accordingly, at one disc per food item. The monkeys were then given 12 discs and allowed to trade them one at a time for whichever foodstuff they preferred.

Once the price had been established, though, it was changed. The size of the apple portions was doubled, effectively halving the price of apple. At the same time, the number of discs a monkey was given to spend fell from 12 to nine. The result was that apple consumption went up in exactly the way that price theory (as applied to humans) would predict. Indeed, averaged over the course of ten sessions it was within 1% of the theory's prediction. One up to *Cebus economicus*.

The experimenters then began to test their animals' risk aversion. They did this by offering them three different trading regimes in succession. Each required choosing between the wares of two experimental "salesmen". In the first regime one salesman offered one piece of apple for a disc, while the other offered two. However, half the time the second salesman only handed over one piece. Despite this deception, the monkeys quickly worked out that the second salesman offered the better overall deal, and came to prefer him.

In the second trading regime, the salesman offering one piece of apple would, half the time, add a free bonus piece once the disc had been handed over. The salesman offering two pieces would, as in the first regime, actually hand over only one of them half the time. In this case, the average outcome was identical, but the monkeys quickly reversed their behaviour from the first regime and came to prefer trading with the first salesman.

In the third regime, the second salesman always took the second piece of apple away before handing over the goods, while the first never gave freebies. So, once again, the outcomes were identical. In this case, however, the monkeys preferred the first salesman even more strongly than in the second regime.

What the responses to the second and third regimes seem to have in common is a preference for

avoiding apparent loss, even though that loss does not, in strictly economic terms, exist. That such behaviour occurs in two primates suggests a common evolutionary origin. It must, therefore, have an adaptive explanation.

What that explanation is has yet to be worked out. One possibility is that in nature, with a food supply that is often barely adequate, losses that lead to the pangs of hunger are felt more keenly than gains that lead to the comfort of satiety. Agriculture has changed that calculus, but people still have the attitudes of the hunter-gatherer wired into them. Economists take note.

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SCIENCE AND TECHNOLOGY
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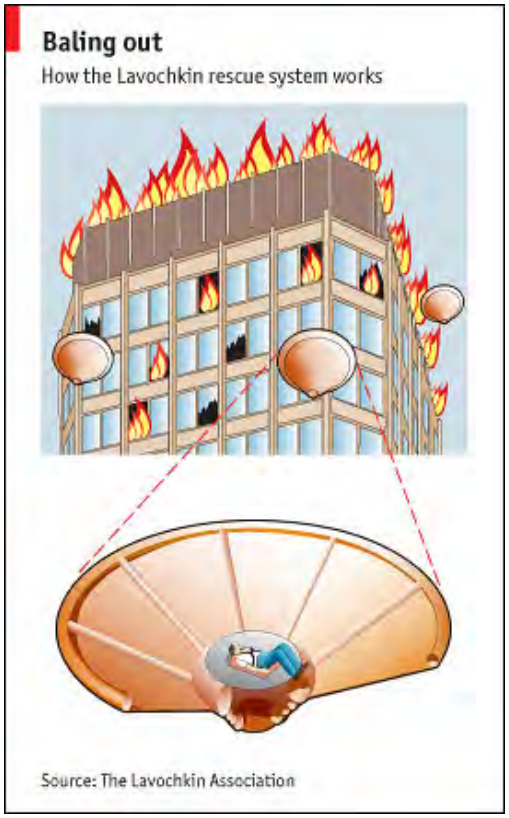
About sponsorship

Safety

Burning ambitions

Jun 23rd 2005 | PARIS
From The Economist print edition

A Russian-designed system for surviving fires in tall buildings



THE Paris Air Show is a notoriously chaotic affair. This year's, which finished on June 19th, was no different from usual. But in a quiet corner of the show, a new way of clocking up air miles was to be found. It looks like a small, orange, inflatable swimming pool with a pointy underside. And strapped inside it is a Biggles-like doll complete with goggles, moustache and flying scarf. It is an escape-pod for people trapped in tall, burning buildings. And it is the product of the Lavochkin Association, an aerospace firm based in Khimki, near Moscow.

There is, at the moment, no convenient way to leave a tall building if the emergency staircases are on fire and the fire brigade has not arrived or its ladders will not reach. Nor are conventional parachutes an answer. As is well known to participants in the sport of Base Jumping (a mind-bogglingly dangerous activity that involves parachuting from static objects), parachutes have problems when launched from tall buildings. For a start, they may not have time to open properly. Even if they do, they can get snagged on the way down. And on top of that, if a building is burning they are liable to catch fire. Hence the Lavochkin escape pod—or “rescue system”, as the firm prefers to call it.

According to Yuri Boulanov, one of Lavochkin's representatives at the air show, the idea is to create a cheap, inflatable structure that can be compressed into a backpack, like a parachute. The pod is designed with an inflatable tube around its edges, which should cause it to bounce off the walls of a building. And the final version will be made from some, as yet unspecified, fire-retardant material. As a bonus, and unlike a parachute, it will operate safely from altitudes of five metres and above—which

would make it suitable even for the top floors of houses.

In an emergency, someone wishing to leave in a hurry would strap on the backpack and jump, pulling a ring as he did so. The pod would inflate, surround him instantly and bear him gently to the ground. At least, that is what happens to the digital simulation in the company's promotional video.

The pod on display at Lavochkin's stand was actually a one-metre diameter prototype. The full-scale device, currently undergoing tests with a sensor-loaded dummy as its passenger—is six metres across and should be able to carry someone weighing up to 120kg. Mr Boulanov says the commercial version should cost around $1,000.

If it all sounds unlikely, it is worth remembering that it is now possible to lob a spacecraft all the way to Mars and have it land safely using an inflatable shell similar to Lavochkin's. Now all that is needed is some way of getting through the sealed windows with which most tall building are glazed.

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Economist.com PRINT EDITION
BOOKS AND ARTS

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About sponsorship

Horatio Nelson

Conjuror of victory

Jun 23rd 2005
From The Economist print edition

How Lord Nelson, a methodical and conservative man, became a romantic hero

THE bicentennial of the battle of Trafalgar does not fall until October 21st. But a long season of festivities begins next week with a fleet review off Spithead involving 35 navies—including, gallantly, those of France and Spain. A battle re-enactment in the Solent will use ten tonnes of gunpowder. That's about as much as one ship, *HMS Victory*, Nelson's flagship, used during the battle itself, but still enough for a most satisfying pop. Along the British coast, nearly every harbour will hold some sort of activity. Events are also planned at Toulon and Cadiz, principal naval bases of France and Spain, and at St Paul's Cathedral in London, where Horatio Nelson's body was buried after the battle.

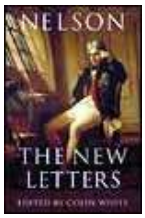
There is a flood of books too. The fascination with Nelson's battle successes and his love affair with Emma Hamilton has ensured that the Nelson industry has been flourishing for two centuries. There are more than 100 Nelson biographies, with well over ten times that number of books on the admiral and the American revolutionary and Napoleonic wars. Do any of these new books really add anything to the Nelson story? Yes.

For a start—and this is somehow typical of the man—Nelson has fresh and voluble ways of telling his own story. Until not long ago historians assumed that most of Nelson's correspondence was in the public domain—notably in the seven-volume collection of letters edited by Sir Nicholas Nicolas and published in 1844-46. In 1999 the Royal Naval Museum in Portsmouth chose to test this assumption by commissioning “The Nelson Letters Project”, led by Colin White, an occasional reviewer for *The Economist*, who is the museum's deputy director and currently on secondment to the National Maritime Museum, Greenwich, to oversee the Trafalgar festivities. By revisiting archives in Britain and elsewhere, Mr White and colleagues have unearthed 1,300 uncatalogued Nelson letters, a good 20% more than were known about before. About two-fifths of these are private correspondence to friends, colleagues and family; others have to do with intelligence and patronage. A big part of the new material is made up of copies of his orders to his captains.

While not quite the new Nelson “autobiography” that Mr White claims for it, the collection, covering all periods of Nelson's life, is nonetheless riveting. The admiral that emerges is open, engaged, alive; he writes as one imagines he spoke. Passages cut out or ignored by prudish Victorian editors show how passionately Nelson corresponded with Lady Hamilton almost to the end. A brief letter, written at sea, to one of his captains, Thomas Fremantle, underscores both his passion for her and his closeness to the officers under him. “My dear Fremantle—If you don't come here on Sunday to Celebrate the Birthday of Santa Emma Damn me if I ever forgive you, so much from your affectionate Friend as you behave on this occasion.”

Also published for the first time is the written battle plan for the Nile campaign of 1798. Nelson was chasing the French fleet that had landed Napoleon in Egypt, threatening British possessions in India. This letter anticipates the better known 1805 battle plan, “The Nelson Touch”. In large letters, boldly inked, are the

Nelson: The New Letters
Edited by Colin White



Boydell Press; 592 pages; $39.95 and £25

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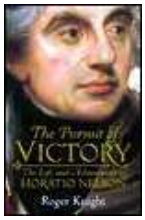
The Pursuit of Victory: The Life and Achievement of Horatio Nelson
By Roger Knight

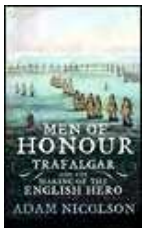


Penguin/Allen Lane; 874 pages; £30

Buy it at
Amazon.co.uk

Men of Honour: Trafalgar and the Making of the English Hero
By Adam Nicolson

words: “The Destruction of the Enemy's Armament is the Sole Object”, proof of Nelson's determination to annihilate the enemy. Perhaps the most striking new find, though, is a rough sketch from early September 1805, about the tactics Nelson intended to use against the Franco-Spanish fleet. Where Nelson intends to show how the centre of the enemy's line was to be cut, his pen digs emphatically into the paper. The spine-tingling sense, Mr White says, is of standing over Nelson's shoulder.



HarperCollins; 341 pages; £16.99. To be published in America by HarperCollins in October

Buy it at
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Corbis

Roger Knight, of the University of Greenwich, is not the first Nelson biographer to make use of new materials, but he is the most thorough. He dismisses many of the old canards about Nelson, recycled to this day out of suspect secondary sources. He does not always take Nelson at his word, letting others speak too. The result is a wonderfully clear portrait of a complex man, seen squarely in his time. There is every reason to think that this superb work will become the definitive Nelson biography.

Mr Knight's story is of how Nelson came to gain what the author calls a “psychological ascendancy” over his adversaries at sea, paralleled in history only by Napoleon on land. Mr Knight argues that very little in his early career marked Nelson out as a cut above a talented generation of young officers, bar great good luck. He was helped to sea by a naval uncle and was promoted to lieutenant at the start of the American revolutionary war, ensuring a rapid rise at a time when officers were in short supply. As a young post-captain of blatantly immature political skills, Nelson was fortunate to spend years in the West Indies rather than closer to London's riven party politics, but even abroad he earned the lasting displeasure of the king, George III, by allowing his head to be turned by the boorish, bullying Prince William Henry, later Duke of Clarence and the king's younger son.

Much later, in 1799, it was turned again by the Queen of Naples, Marie-Antoinette's sister, during Nelson's attempted defence of the kingdom, an English ally. Nelson's moral and political judgment were deeply compromised when he allowed English ships to be used as anti-republican kangaroo courts by Neapolitans seeking revenge on their compatriots. Even an admiral was hung, and English officers were appalled that their vessels had become such “engines of turpitude”. The blame was entirely Nelson's, and lay in his infatuation with Emma Hamilton, the queen's confidante.

Yet despite his flaws, Mr Knight contends, Nelson dug deeper at every stage for new skills and talents. His disgrace at Naples was redeemed two years later at the battle of Copenhagen, not just by the famous naval victory, but by a masterly diplomatic settlement immediately afterwards.

Mr Knight describes well how Nelson was, in the words of a contemporary, “in some respects, as trivial a man as ever made a name”. His vanity in always wearing the baubles awarded by foreign powers was ridiculed by his superiors. Vain he was. Yet, just like Winston Churchill with his cigar and boiler suit, Nelson understood better than they the part that decorations played in his style of leadership.

Above all, Nelson took a number of supreme battle decisions, any one of which would have earned him naval immortality. At St Vincent in 1797, he wore his ship out of the line and boarded two Spanish ships. At the Nile in 1798—perhaps his finest action—he changed the course of the war by sailing in the fading light straight into Aboukir Bay to destroy the anchored French fleet, thus isolating Napoleon's army. The stunning seamanship required, notably in anchoring by the stern in order to come to a halt opposite the French ships, was a measure of the trust in which he held his officers and men. At

Trafalgar, almost a summing-up of what went before, Nelson shattered the combined fleet by taking it head-on.

Inspiration, informality and attention to detail were three of Nelson's chief priorities. As Cuthbert Collingwood, his second-in-command, wrote soon after Trafalgar: “He possessed the zeal of an enthusiast, and everything seemed, as if by enchantment, to prosper under his direction. But it was the effect of system, and nice combination, not of chance.” Mr Knight sets his Nelson in the context of an 18th-century navy where professional zeal and individualism in the pursuit of a shared goal often made up for a lack of social advantages. Nelson was of his time, for the navy later quickly became aristocratic and hierarchical. Adam Nicolson, in a strikingly original way, also attempts to set the navy at Trafalgar in a broader context. By addressing history's “underlayer”, he paints the mental landscape of the men who went into battle, asking why and how “the idea of the hero flowered here”.

Some historians will not like this approach, and not just because Mr Nicolson quotes earlier, discredited, biographers of Nelson. By the author's own confession, his is a slippery approach to history. Broadly, Mr Nicolson argues that a tradition of violence had long run through English affairs. By the end of the 18th century, the sequence of violent and revolutionary events in Europe, and the Napoleonic threat of invasion, had bred a form of millenarian fever in England, full of blood-drenched visions of the end of time, when “utter violence gives way to the moment of utter peace”. The only radical vision that an alarmed conservative elite could allow full outward expression of was that of an “unrivalled creation of a God-blessed, ragingly commercial British empire”. Nelson was seen as “the fleet-burning conjuror of victory”, though in reality he was methodical and politically conservative. The parallels of Nelsonian war with the apocalyptic Romanticism of William Wordsworth, Samuel Taylor Coleridge and even William Blake are underscored: Nelson's was the hand that dared seize the fire.

The Nelsonian essence of battle, Mr Nicolson explains, was the “liberation of individual energies to ensure victory”. There is, he suggests, a parallel between the way Adam Smith thought of economics and Nelson thought of war: the individual's uncompromising pursuit of individual ends also best serves the general good. While the Spanish fleet was marked by a peasant/aristocratic mentality, and the French fleet by an uncomfortable mix of ancient and revolutionary, “Nelson's fleet carried a capitalist charge.”

And some charge. Mr Nicolson brings to life superbly the horror, devastation and gore of Trafalgar. After the battle, and during the long storm that followed, with Nelson dead from a musket ball in the spine, English sailors performed extraordinary feats of seamanship and bravery, saving the lives of thousands of injured and exhausted opponents. Charity after victory, honour and self-restraint: these colour Britons' view of themselves today. Only Churchill—and he was not a military man—has shaped the British national sense of identity more.

Nelson: The New Letters.
Edited by Colin White.
Boydell Press; 592 pages; $39.95 and £25

The Pursuit of Victory: The Life and Achievement of Horatio Nelson.
By Roger Knight.
Penguin/Allen Lane; 874 pages; £30

Men of Honour: Trafalgar and the Making of the English Hero.
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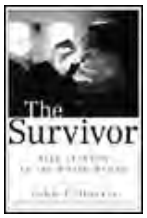
About sponsorship

Bill Clinton

American idol

Jun 23rd 2005
From The Economist print edition

The Survivor: Bill Clinton in the White House
By John F. Harris



Random House; 504 pages; $29.95

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WHATEVER else Bill Clinton deserves—and many Americans still argue about that—a better literary legacy is long overdue. So far his presidency has received a lousy treatment from three different sorts of writers: first, crude hatchet jobs by what his wife called the vast right-wing conspiracy (see box on next page); second, absurdly pro-Clinton apologies from loyalists who blame conservatives for everything; and lastly a chaotic meandering "diary dump" from the man himself (now available in paperback at 1,056 pages).

So what a relief to welcome John Harris's "The Survivor", the definitive account so far of the Clinton White House. Mr Harris, a *Washington Post* correspondent, decides in the end that Mr Clinton was basically a good thing. But on the way, he calmly delivers more than enough ammunition for Clinton haters to feast upon. Entries in the index under Bill Clinton include "sexual excess of", "angry outbursts of" and "deceptiveness seen in".

At times Mr Clinton's flaws are excruciating. Mr Harris begins with the announcement of his candidacy for president in Little Rock. "A lifetime of preparation had culminated in the usual fashion for Clinton: in a swirling cloud of last-minute chaos and indecision." Many of his closest advisers did not really know what he believed in or what skeletons lay in his closet. Much later, when his lawyer tells him that one Monica Lewinsky is on a witness list, the president asks incredulously, "Do you think I'm fucking crazy?" implying that he had "retired" from such activities, even though he had been stroking her hair in his office only hours before.

Yet there is also much to sympathise with, including the peerless politician, capable of making lines like "I feel your pain" sound genuine, largely because, for that instant, they were. An idealist of sorts emerges, intrigued by lofty ideas and utterly convinced that he can make America a better place. And there is the survivor, who never gave up. "I'm the little rubber clown you had as a kid. The harder you hit me, the faster I come back."

These traits did not always work in his favour. Once in office, his uncanny ability to narrow the gap between leader and voters served him less well: the press corps got fed up with his all-too-human vengefulness, and the right loathed him and his wife for getting away with it. "You know, he eats too much, he loves sports too much, he talks too much," one adviser explains. "He is not remote in the way that other presidents have been so you are more free to love him or hate him the way you would anyone."

Mr Harris's main defence of Mr Clinton is that he did the right thing in the end. That is not to deny that he made some big mistakes—the health-care fiasco for one. Nor is it to deny that he drove people mad with his vacillations. But he was a much more conscientious president than his personal life implied. He chose good people, notably Al Gore (who emerges well from this account) and the treasury team. And he learnt from his mistakes.

A complex man himself, Mr Clinton worked hard at complex decisions. After agonising for months, Mr Clinton eventually decided to concentrate his economic policy on reducing the deficit, even though he had promised a spending splurge in the campaign. He eventually agreed to welfare reform, although it was a Republican idea. And in the end he intervened successfully in the Balkans, although the polls told him not to do so.

Will this make Mr Clinton less loathed? Probably not. But it provides the best explanation of how this

infuriating man led America fairly shrewdly for eight years.

The Survivor: Bill Clinton in the White House.
By John F. Harris.
Random House; 504 pages; $29.95

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About sponsorship

New Chinese art

Seeing red

Jun 23rd 2005 | BASEL AND VENICE
From The Economist print edition

Two leading art fairs are showcasing new art from China

A CHINESE farmer built a flying machine out of scrap metal and aluminium foil. He insisted it could fly to the moon. Whenever an engineer or some other nay-sayer explained that it could not work, he simply replied: “This is not my understanding,” and continued to test his machine for the fateful hour of take-off.

Shooting the breeze

This would-be UFO, farmer included, is one of the art installations in China's first pavilion at the Venice Biennale, presented by Peng Yu and Sun Yuan, two conceptual artists who had read about him in a newspaper and asked him to build his machine in Venice. Now named “Farmer Du Wenda's Flying Saucer”, the farmer's stubborn attempt to jump from feudal culture to outer space is seen by the artists as a symbol of China's leap into modernity.

“What makes the UFO project different”, explains Cai Guo-Qiang, the curator of the Chinese pavilion, is a desire to enter into dialogue with the rest of the world, rather than remain isolated. Mr Cai, a prominent New York-based artist who won the prestigious Golden Lion award at the 1999 Biennale, has chosen five artists working in China today to present a slice of the art scene there rather than an authoritative view; his is the Biennale's most impressive pavilion.

With one eye on the site—a derelict oil depot at the end of the Arsenale, the defunct Renaissance naval yard—Mr Cai chose large-scale installations that would not be cowed by the unwieldy spaces. One is Xu Zhen's “Shout”, a multi-screen film installation where images of Shanghai crowds project across a vast hall of empty oil drums, with random shouts from off-camera. Another is the outdoor pavilion, designed by Yung Ho Chang, one of the world's most closely watched Chinese architects, who earlier this year was appointed chair of MIT's school of architecture. “Bamboo shoots”, his spiralling modern design, is made from traditional Chinese basket-weaving techniques. “I wanted the structure to be open to the elements,” Mr Yung says. An important feature of traditional Chinese architecture is the idea of the platform or “tam”. “In Beijing's Heavenly Temple”, the architect explains, “the ‘tam' is the wide open space for communing with the gods. I wanted to consider that idea here.”

According to Fan Di'an, vice-president of the Central Academy of Fine Arts in Beijing, the last five years has seen a sea change in Chinese policy towards the arts. “Ever since Mr Cai won the Golden Lion, the government has realised that art can be a good ambassador for China.” He should know. When Jiang Zemin, a former Chinese premier, returned from a visit to France embarrassed that he could not discuss painting with Jacques Chirac, he summoned Professor Fan for tutorials.

Indeed, China seems to be embracing art at the moment and the art world is blowing air kisses back. Last month a sale of Chinese contemporary art at Christie's in Hong Kong fetched a record $16m, while last week a Chinese delegation of collectors, curators, architects and artists visited the Basel art fair, the world's premier marketplace for contemporary art. A conference there, entitled “The Future of the Museum: Profile China” was hugely over-subscribed. Moderated by Hans Ulrich Obrist, a curator who first met the artists and intellectuals who went into exile after Tiananmen Square in 1989 in Paris, the conference mixed older artists, such as China's answer to Joseph Beuys, Huang Yong Ping, and curator Hou Han Ru, with a younger generation based in China. Others included Guan Yi, a wealthy Beijing-based collector, and Uli Sigg, a Swiss businessman and former ambassador to China, whose collection of contemporary Chinese art is now on show in Bern.

Stimulated by the prospect of the 2008 Olympic Games in Beijing and the Shanghai World Fair two years later, the Chinese government wants to build 1,000 new museums by 2015—including 32 in Beijing and 100 in Shanghai—and both cities already have *biennali* of their own.

Mr Sigg, who has travelled around much of China over the past quarter-century collecting its contemporary art, has yet to be convinced by all this talk of a boom in museums. “I am impressed by all the new hardware but, as a collector, I am interested in the software—the art, people, education and memory function that go inside a museum. Most Chinese institutions lack that software and there is a memory gap of 20 years between 1980 and 2000, when no Chinese institution collected Chinese contemporary art.”

Mr Sigg's is a rare voice of caution. China's support for its increasingly successful—and profitable—artists and galleries may well be no more than a figleaf for a repressive political system, but the western art world, eager for a new audience and a new market, likes seeing red.

The Chinese pavilion is at the Venice Biennale until November 8th, and afterwards at the Zendai Museum of Modern Art, Shanghai.

“Mahjong: Contemporary Chinese Art from the Sigg Collection” is at the Kunstmuseum, Bern, until October 16th, and at Hamburger Kunsthalle, Hamburg, in autumn 2006.

“Huang Yong Ping: A Retrospective” is at the Walker Art Centre, Minneapolis, from October 16th until January 15th 2006.

The Beijing Biennale opens on September 20th, while the next Shanghai Biennale takes place in late 2006

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About sponsorship

Hillary Clinton

O lucky woman!

Jun 23rd 2005 | WASHINGTON, DC
From The Economist print edition

THERE is only one thing more useful in politics than having the right friends, and that is having the right enemies. Mrs Clinton has long owed a big debt to her critics on the deranged right, and, with this week's publication of Edward Klein's "The Truth About Hillary", it is clear that her luck still holds.

There are lots of reasons to distrust or even dislike Mrs Clinton. She exudes an overpowering whiff of entitlement. She seems to believe that successful career women like herself are morally superior to women who stay at home and bake cookies. She was responsible, with Hillarycare, for one of the greatest political debacles of recent years. And, most infuriating of all, she tries to play both the victim and the strong woman. But Mr Klein has succeeded in doing the near impossible: he has written a book that will make all but fire-breathing conservatives sympathetic to her cause.

Mr Klein relies on much the same methods as Michael Moore—mixing well-known facts with wild innuendo. The best that can be said for him is that he is a zealous muck-raker. He hoovers up anything and everything that might reinforce his claim that Mrs Clinton is willing to lie, bully, cheat and manipulate people in her quest for power, including the fact that, as an adolescent, she nurtured a fierce ambition to become an astronaut.

The book is at its most repugnant when it comes to the question of sex. Mr Klein repeatedly hints that the former first lady has a taste for the Sapphic arts. Wasn't she at Wellesley, where, we are informed, lesbianism is strikingly common? And aren't many of her closest friends and aides lesbians? In the book's most bizarre passage, he even suggests that the Clintons' daughter, Chelsea, was the product of a marital rape.

Mr Klein should be ashamed of himself for sinking to such depths. And Mrs Clinton can sail on to the Democratic primary confident that this book will not do her the least bit of harm.

The Truth About Hillary: What She Knew, When She Knew It, and How Far She'll Go to Become President
By Edward Klein
Sentinel; 336 pages; $24.95

The Truth About Hillary: What She Knew, When She Knew It, and How Far She'll Go to Become President
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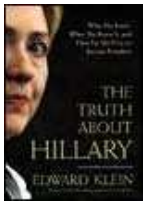

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Obesity in America

Miss Piggy

Jun 23rd 2005
From The Economist print edition

"YOU'RE too fat to fuck." The first line of this fleshy, uninhibited memoir sets the tone of this sad tale of a fat child who becomes a fat woman. Writing it was painful for the author, but it makes for painful reading too; as terrible and as captivating, in its way, as the crashed car steaming at the side of the road.

Judith Moore is, in her own words, a "short squat toad of a woman", a "grotesque and grunting hog". She is ashamed—and resigned to that shame—but she does not want sympathy. Without flinching, she recounts her unhappy childhood. For both herself and her fat father, food "was the source of some of our greatest pleasure and most terrible pain". She writes of the breakdown of her parents' marriage, her father's abandonment of her and the intolerable cruelty inflicted on her by her dainty, petite, vicious mother, who finds her daughter disgusting and whips her with a leather belt saying she is going to "cut the blood" out of her.

Fat Girl: A True Story
By Judith Moore

Hudson Street Press; 208 pages; $21.95. Profile Books; £12.99

Buy it at
Amazon.com
Amazon.co.uk

The young Ms Moore has no friends. She is mercilessly teased and unremittingly unhappy. "My body felt like burdens I was carrying on my back. I felt like a field animal. I was not human." Yet she does not make excuses for her fatness, instead acknowledging that it was, and is still, tightly intertwined with her longing for love. As an adult she still feels starved of love. Gorging on ice cream in the dead of night she writes: "I wanted to say to the ice cream, 'I love you.' I wanted to say, 'You are my mother.' I wanted to whimper, 'Mama, Mama, Mama.' I wanted to weep."

Nothing is too tasteless to be left out. Ms Moore lays out all her self-disgust describing her "clabber thighs" rubbing each other raw, buttocks "grinding like turbines", upper arms as "fat as bolognas that hang from butchers' ceilings", grotesquely meaty body odours.

At the end of "Fat Girl", Ms Moore writes, "Among the reasons people keep sad stories to themselves is that they do not want anyone to feel sorry for them." So, read this heartbreaking book by all means, but don't feel sorry for her. After all, she does not feel sorry for herself. She just feels fat.

Fat Girl: A True Story.
By Judith Moore.
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Economist.com PRINT EDITION OBITUARY
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Obituary

Lillian Lux

Jun 23rd 2005
From The Economist print edition

Lillian Lux, star of the Yiddish theatre, died on June 11th, aged 86

FOR homesick Jewish immigrants in New York in the early decades of the 20th century, there were few better places than the theatre. There, in a small closed space, in the dark, they could recreate the neurotic, loving, oppressive atmosphere of the *shtetlekh* they had left behind. In that world, lost in the steppes of Russia or the forests of Poland, the fathers were tragic and the mothers scheming; the daughters were pretty and dangerously marriageable; their suitors were Talmudic scholars; and after an hour or so of singing, dancing and fallings-out, it would all end in hugs and tears under the wedding-canopy.

The Lower East Side once boasted 14 Yiddish theatres, with five on Second Avenue alone. They boasted a huge repertory of plays and operettas both classical and folkloric, but the folk plays were the most popular. Lillian Lux made her name with almost continuous performances, from the 1940s onwards, of “A Khasene in Shtetl” (“A Village Wedding”), in which she played the bride. Her husband, Pesach'ke Burstein, played opposite her. Burstein, 22 years her senior, was a Second Avenue matinee idol, able not only to foot it like Fred Astaire in a top hat and tails and to sing Al Jolson's “Sonny Boy” (in Yiddish), but also to whistle like a bird. Whistling, like *klezmer* music, was a *shtetl* thing to do.

Ms Lux and Burstein had met in 1938, when Ms Lux, trained since the age of six at the Yiddish Art Theatre, auditioned for Burstein's tour of Latin America. A *shtetl* scene followed, while her parents appraised whether he was good enough for her; he was, she went, and they were married in Montevideo. Just before the war the couple also toured the remaining, increasingly terrorised, Jewish enclaves in Poland. (Yiddish theatre had always been itinerant, and Burstein had in fact run away with a Polish troupe when he was 15, destroying his family's dreams of the rabbinate for him.) On this occasion, the Bursteins were lucky to catch the last ship out.

Ms Lux wrote plays and operettas for them and, when her twins were born, they eventually joined the act too. It became “The Four Bursteins”. They played Second Avenue and, in summer, did the rounds of resorts in the Catskills where middle-class Jews took their holidays. Increasingly, though—tracking the scattered remnants of European Jewry—they went abroad. Ms Lux took to the boards in Buenos Aires, Johannesburg, Melbourne, Tel Aviv and any number of small towns en route. Wherever there were Yiddish-speakers, and memories of the *shtetl* longing to be resurrected, she would play the crucial,

central role of the blushing village bride. Her blonde hair, only so slightly aided by the peroxide bottle, earned her the name of “the Jewish *shiksa*”.

There was little glamour in these journeys. The family went mostly by bus, their costumes and props stuffed into suitcases, seeking the next little pocket of *Yiddishkeit* in exile. They stayed in cheap hotels. Ms Lux made her children perform even when they had the measles, just as she had performed, when pregnant, under heavy disguise of ostrich feathers. Her daughter found many of the audiences frightening: camp survivors, disfigured, with numbers tattooed on their arms. On one bus trip in Europe they visited a camp, looking at the gas chambers. It was said that people had sometimes gone to their deaths singing tunes from “A Khasene in Shtetl”.

Their audiences, however, were fading away. By the 1950s, Jews in America and elsewhere had largely assimilated. The theatres on Second Avenue emptied, then closed; by the 1990s, only one was left. In the Catskills, the very old crept around the shells of the hotels where Ms Lux, a pretty chorus-girl, had once danced opposite Danny Kaye.

Many Jews, in any case, had always found Yiddish theatre vulgar and the language an embarrassing hybrid. This had been made shockingly obvious when the Four Bursteins toured Israel in the early 1950s. Zionist hooligans broke the theatre windows, and the government imposed a special tax on their show, because it was in Yiddish and not in Hebrew, the proper language of the new state.

A need for roots

Ms Lux's devotion to her enterprise was complete. Travelling and performing were the only life she wanted. Even her children's bar- and bat-mitzvahs were staged as ticket-only events. When, as teenagers, they both left the act, she felt betrayed. Why, she asked, did they want to destroy her livelihood? One reason was that both could see that Yiddish, and its theatre, was a dead end. Another was the feeling that they had missed out on family life.

Night after night, they had sung and danced as an ideal family troupe. But their way of life had guaranteed no neighbours and few friends. They had always moved on too fast to put down roots. Finding the perfect boyfriend or girlfriend was impossible. They had hardly known the rhythm even of regular meals. It was all quite unlike the close, settled, *shtetl* world of Ms Lux's operettas and the Yiddish stage.

She herself, however, did not seem to mind the discrepancy. Well into her 80s, she continued to perform. She was engaged in the business of evoking deep memories of a vanished home: so engaged, it was no wonder she did not have time to make a home herself.

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Overview

Jun 23rd 2005
From The Economist print edition

America's current-account deficit widened to $195 billion in the first quarter of this year, equivalent to 6.4% of GDP. The 12-month deficit rose to yet another record of $717 billion. The **euro area**, by contrast, runs a current-account surplus, but its visible-trade surplus narrowed to $69 billion in the 12 months to April, down from $101.8 billion in the same period a year ago.

Industrial production in **America** rose by 2.7% in the year to May—much larger than the 0.9% rise in output in the euro zone in the year to April. However, the Conference Board's index of American leading indicators fell again in May. The index has dropped in nine of the past 12 months, signalling slower growth ahead.

A half-point cut in interest rates (to 1.5%) by **Sweden's** central bank encouraged speculation that the **European Central Bank** might soon also cut rates. But there is a big difference: Swedish inflation was only 0.1% in the year to May, against 2.0% in the euro area.

European and American bond markets rose. American ten-year bond yields fell to below 4%.

After rising to a record $59.70 a barrel, the price of West Texas Intermediate **crude oil**, a key benchmark, slipped back to $58.

Many **European stockmarkets**, including London, Paris, Frankfurt and Amsterdam, hit new 2005 highs during the week.

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Output, demand and jobs

Jun 23rd 2005
From The Economist print edition

% change on year ago

	GDP			The Economist poll GDP forecasts		Industrial production		Retail sales (volume)		Unemployment % rate		
	latest		qtr*	2005	2006	latest		latest		latest		year ago
Australia	+ 1.9	Q1	+ 2.8	+ 2.6	+ 3.2	– 0.4	Q4	+ 1.8	Q1	5.1	May	5.5
Austria	+ 2.0	Q1	+ 0.8	+ 2.0	+ 2.0	+ 1.9	Mar	+ 3.2	Mar	4.6	May	4.4
Belgium	+ 1.8	Q1	– 0.1	+ 1.6	+ 2.1	– 1.5	Apr	+ 3.4	Mar	12.2	May†	12.3
Britain	+ 2.7	Q1	+ 2.0	+ 2.4	+ 2.1	– 1.9	Apr	+ 1.3	May	4.7	Apr††	4.8
Canada	+ 3.3	Q1	+ 2.3	+ 2.6	+ 2.9	+ 1.3	Mar	+ 4.0	Mar	6.8	May	7.1
Denmark	+ 0.8	Q1	+ 0.6	+ 2.1	+ 2.2	– 2.4	Apr	+ 8.2	Apr	5.9	Apr	6.5
France	+ 1.7	Q1	+ 0.8	+ 1.8	+ 2.0	nil	Apr	+ 1.0	Apr	10.2	Apr	10.0
Germany	+ 1.1	Q1	+ 4.2	+ 1.1	+ 1.4	+ 1.8	Apr	nil	Mar	11.8	May§	10.5
Italy	– 0.2	Q1	– 1.8	+ 0.3	+ 1.3	+ 0.8	Apr	+ 1.2	Mar	8.0	Dec	8.2
Japan	+ 1.3	Q1	+ 4.9	+ 1.4	+ 1.8	+ 0.6	Apr	+ 3.6	Apr	4.4	Apr	4.7
Netherlands	– 0.3	Q1	– 0.6	+ 0.8	+ 1.6	– 0.7	Apr	+ 0.6	Mar	6.6	May**	6.5
Spain	+ 3.3	Q1	+ 3.5	+ 2.8	+ 2.7	+ 7.1	Apr	+ 3.0	Apr	10.0	Apr	11.2
Sweden	+ 1.4	Q1	+ 1.1	+ 2.8	+ 2.8	– 2.1	Apr	+ 4.0	Apr	5.2	May†	5.7
Switzerland	+ 0.8	Q1	+ 0.2	+ 1.2	+ 1.7	– 0.3	Q1	– 0.3	Mar	3.7	May†	3.8
United States	+ 3.7	Q1	+ 3.5	+ 3.5	+ 3.2	+ 2.7	May	+ 5.3	Apr	5.1	May	5.6
Euro area	+ 1.3	Q1	+ 2.0	+ 1.4	+ 1.8	+ 0.9	Apr	– 0.9	Apr	8.9	Apr	8.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 2.0	Q1	+ 0.5	na	na	+ 1.2	Apr	+ 6.4	Apr	10.2	May†	11.6
Greece	+ 3.5	Q1	na	na	na	– 3.2	Apr	+ 7.1	Mar	10.2	Dec	9.8
Iceland	+ 2.9	Q1	na	na	na	na		na		2.3	Apr†	3.5
Ireland	+ 2.8	Q4	na	na	na	– 6.4	Apr	+ 4.6	Mar	4.2	May	4.6
Luxembourg	+ 3.8	Q4	na	na	na	+ 2.4	Mar	– 3.1	Apr	4.6	Apr	4.2
New Zealand	+ 3.6	Q4	+ 2.4	na	na	+ 3.5	Q4	+ 5.8	Q1	3.9	Q1	4.2
Norway	– 0.8	Q1	+ 2.2	na	na	+ 4.0	Apr	+ 8.5	Apr	4.6	Apr**	4.3
Portugal	+ 0.1	Q1	+ 0.8	na	na	+ 0.7	Apr	+ 2.0	Apr	7.5	Q1†	6.4

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡New series. ††Feb-Apr; claimant count rate 2.7% in May. §EU harmonised rate 9.6% in Apr. **Mar-May.

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Prices and wages

Jun 23rd 2005
From The Economist print edition

% change on year ago

	Consumer prices		The Economist poll consumer prices forecast		Producer prices		Wages/earnings	
	latest	year ago	2005	2006	latest	year ago	latest	year ago
Australia	+ 2.4 Q1	+ 2.0	+ 2.6	+ 2.6	+ 6.0 Q1	– 1.1	+ 4.5 Q1	+ 5.0
Austria	+ 2.3 May	+ 2.1	+ 2.1	+ 1.6	+ 1.3 May	+ 6.1	+ 2.3 May	+ 2.1
Belgium	+ 2.5 May	+ 2.6	+ 2.0	+ 1.7	+ 3.3 Apr	+ 2.6	+ 2.6 Apr	+ 2.3
Britain	+ 1.9 May*	+ 1.5	+ 1.9	+ 1.9	+ 2.7 May	+ 2.5	+ 4.6 Apr†	+ 4.4
Canada	+ 2.4 Apr	+ 1.6	+ 2.1	+ 2.1	+ 1.5 Apr	+ 2.3	+ 2.5 Feb	+ 3.5
Denmark	+ 1.5 May	+ 1.3	+ 1.4	+ 1.7	+ 3.0 May	+ 2.8	+ 3.1 Q1	+ 3.3
France	+ 1.5 May	+ 2.6	+ 1.6	+ 1.6	+ 3.1 Apr	+ 1.3	+ 2.9 Q1	+ 2.8
Germany	+ 1.7 May	+ 2.0	+ 1.4	+ 1.0	+ 1.7 May	+ 3.6	+ 1.6 Apr	+ 1.1
Italy	+ 1.9 May	+ 2.3	+ 1.9	+ 1.8	+ 4.4 Apr	+ 1.7	+ 3.5 Apr	+ 2.8
Japan	nil Apr	– 0.4	– 0.1	+ 0.3	+ 1.8 May	+ 0.9	+ 0.5 Apr	+ 1.2
Netherlands	+ 1.3 May	+ 1.5	+ 1.4	+ 0.6	+ 4.7 Apr	+ 2.3	+ 0.6 May	+ 1.5
Spain	+ 3.1 May	+ 3.4	+ 2.9	+ 2.7	+ 5.0 Apr	+ 2.6	+ 3.0 Q1	+ 3.2
Sweden	+ 0.1 May	+ 0.7	+ 0.7	+ 1.5	+ 2.7 Apr	– 0.2	+ 4.2 Mar	+ 1.5
Switzerland	+ 1.0 May	+ 0.9	+ 1.2	+ 1.2	+ 0.5 May	+ 1.4	+ 0.9 2004	+ 1.4
United States	+ 2.8 May	+ 3.1	+ 2.9	+ 2.5	+ 3.5 May	+ 4.7	+ 2.6 May	+ 2.0
Euro area	+ 2.0 May	+ 2.5	+ 1.8	+ 1.5	+ 4.2 Apr	+ 1.4	+ 3.1 Q1	+ 3.0
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	+ 0.8 May	– 0.1	na	na	+ 2.3 May	+ 1.7	+ 4.1 Q1	+ 4.2
Greece	+ 3.2 May	+ 2.9	na	na	+ 4.3 Apr	+ 4.6	na	na
Iceland	+ 2.8 Jun	+ 3.9	na	na	+ 4.5 May	+ 5.0	+ 6.7 Apr	+ 4.0
Ireland	+ 2.4 May	+ 1.7	na	na	– 1.8 Apr	– 4.1	+ 5.1 Q4	+ 4.5
Luxembourg	+ 2.4 May	+ 2.3	na	na	+ 8.9 Apr	+ 6.2	+ 0.6 Feb	+ 4.0
New Zealand	+ 2.8 Q1	+ 1.5	na	na	+ 4.2 Q1	– 0.6	+ 2.5 Q1	+ 2.2
Norway	+ 1.6 May	+ 1.0	na	na	+ 9.2 May	+18.8	+ 3.7 Q1	+ 3.5
Portugal	+ 1.8 May	+ 2.4	na	na	+ 4.4 Apr	+ 1.1	– 1.6 Apr	– 1.4

*New series. RPI inflation rate 2.9% in May. †Feb-Apr.

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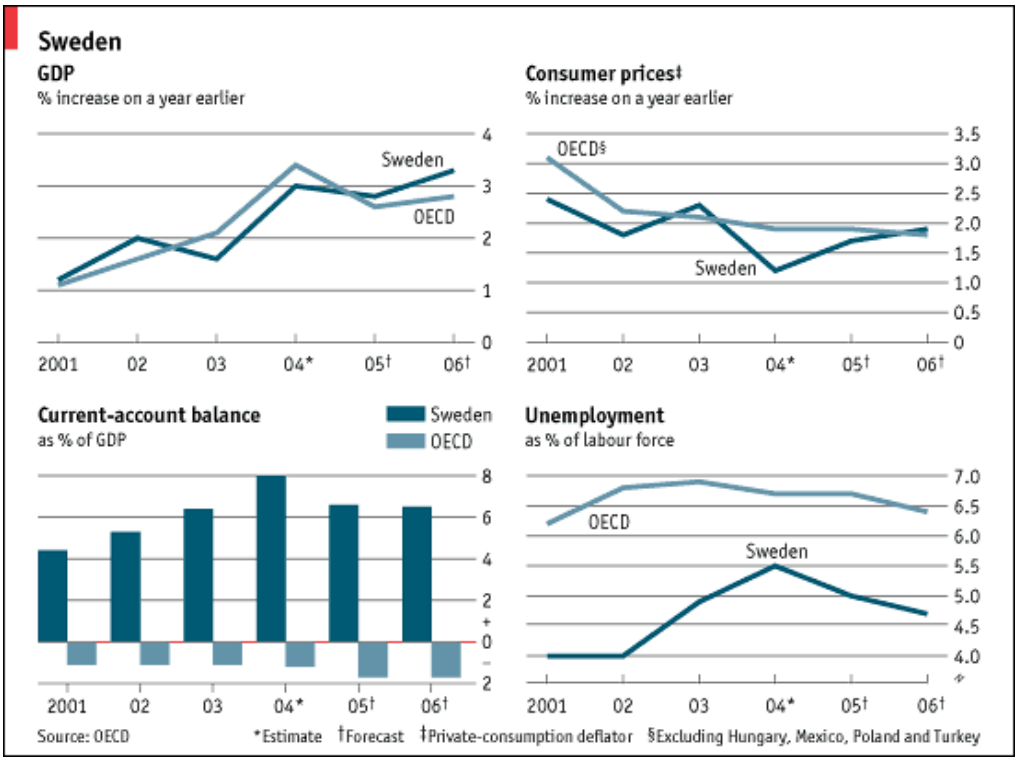
Sweden

Jun 23rd 2005
From The Economist print edition



Sweden's central bank took markets by surprise this week and cut interest rates by one half of a percentage-point. For months, the Riksbank had ignored calls for lower interest rates; it responded only after clear evidence that economic growth had slowed sharply, to an annual rate of only 1.4% in the year to the first quarter. However, the OECD's latest country survey of Sweden still forecasts robust GDP growth of 2.8% in 2005, and 3.3% in 2006—faster than the OECD average. The OECD says that the Swedish economy has undergone impressive reforms since the mid-1990s, but its key challenge will be to maintain the core of its social-welfare system as its population ages. Sweden is better placed than most other OECD countries to do this, because it still has a budget surplus. Its productivity growth has also picked up in recent years thanks to structural reforms.

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Money and interest rates

Jun 23rd 2005
From The Economist print edition

	Money supply* % change on year ago			Interest rates % a year (Jun 22nd 2005)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 4.0	+ 9.0	Apr	5.65	5.48	5.23	5.22	5.90	6.31
Britain	+ 4.3	+11.6	May	4.77	4.78	4.17	4.25	5.15	5.20
Canada	+13.5	+10.8	Apr	2.44	2.01	2.80	3.85	5.23	5.34
Denmark	+17.7	+11.3	Apr	2.20	2.30	1.94	3.07	4.47	4.90
Japan	+ 4.0	+ 1.5	May	0.02	0.02	0.07	1.24	1.87	1.38
Sweden	+ 2.2	+ 3.7	Apr	1.49	1.97	1.82	2.98	4.62	2.63
Switzerland	– 7.3	+ 2.3	May	0.75	0.47	0.82	1.94	2.85	1.85
United States	+ 2.7	+ 4.3	May	3.31	1.40	3.60	3.94	4.70	5.03
Euro area†	+ 9.3	+ 6.7	Apr	2.10	2.12	1.98	3.11	4.31	3.36

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.24%, Japan No. 270 1.27%. Central bank rates: US fed funds 3.00%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 4.75%. Sources: Bank of Canada, Commerzbank, Danske Bank, J.P. Morgan Chase, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Jun 23rd 2005
From The Economist print edition

2000=100

	Jun 14th	Jun 21st*	% change on one month	% change on one year
Dollar index				
All items	133.5	134.7	+ 1.2	+ 2.4
Food	129.3	133.5	+ 3.3	+ 0.5
Industrials				
All	139.0	136.1	– 1.4	+ 5.0
Nfa†	128.7	114.6	–11.5	–16.1
Metals	144.6	147.9	+ 3.7	+17.5
Sterling index				
All items	112.0	111.8	+ 1.3	+ 2.1
Euro index				
All items	102.5	102.6	+ 4.9	+ 2.1
Yen index				
All items	135.4	135.5	+ 2.0	+ 1.9
Gold				
$ per oz	426.85	437.05	+ 4.6	+10.4
West Texas Intermediate				
$ per barrel	54.95	58.68	+18.2	+54.3

* Provisional. † Non-food agriculturals.

Our commodity-price index was rebased in February 2005.

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Stockmarkets

Jun 23rd 2005
From The Economist print edition

Market indices

	Jun 22nd	2005 high	2005 low	% change on one week	% change on record high	% change on Dec 31st 2004 in local currency	% change on Dec 31st 2004 in $ terms
Australia (All Ordinaries)	4,232.1	4,267.3	3,905.5	+ 0.7	– 0.8	+ 4.4	+ 3.8
Austria (ATX)	3,006.7	3,030.2	2,415.0	+ 2.0	– 0.8	+23.7	+10.4
Belgium (Bel 20)	3,137.8	3,197.3	2,958.8	+ 0.9	–14.8	+ 7.0	– 4.5
Britain (FTSE 100)	5,099.3	5,099.3	4,783.6	+ 1.6	–26.4	+ 5.9	+ 0.5
Canada (Toronto Composite)	10,051.5	10,051.5	9,006.2	+ 1.9	–11.7	+ 8.7	+ 5.4
Denmark (KBX)	312.4	312.4	257.8	+ 2.8	nil	+21.2	+ 8.0
France (SBF 250)	2,936.3	2,936.3	2,633.6	+ 1.1	–33.1	+11.5	– 0.5
(CAC 40)	4,229.6	4,229.6	3,816.1	+ 1.1	–38.9	+10.7	– 1.2
Germany (DAX)*	4,619.6	4,619.6	4,178.1	+ 1.6	–42.7	+ 8.5	– 3.1
Italy (S&P/MIB)	32,385.0	32,856.0	30,645.0	– 0.7	–35.4	+ 4.8	– 6.5
Japan (Nikkei 225)	11,547.3	11,966.7	10,825.4	+ 1.2	–70.3	+ 0.5	– 5.3
(Topix)	1,173.3	1,203.3	1,109.2	+ 1.3	–59.3	+ 2.1	– 3.9
Netherlands (AEX)	382.4	382.4	347.0	+ 1.7	–45.5	+ 9.8	– 2.0
Spain (Madrid SE)	1,048.3	1,048.8	950.9	+ 1.2	– 8.5	+ 9.3	– 2.4
Sweden (Affarsvarlden Gen)	246.4	246.4	218.9	+ 1.7	–38.5	+11.4	– 3.4
Switzerland (Swiss Market)	6,286.9	6,294.2	5,669.6	+ 0.5	–25.3	+10.4	– 1.2
United States (DJIA)	10,587.9	10,940.6	10,012.4	+ 0.2	– 9.7	– 1.8	– 1.8
(S&P 500)	1,213.9	1,225.3	1,137.5	+ 0.6	–20.5	+ 0.2	+ 0.2
(NASDAQ Comp)	2,092.0	2,152.2	1,904.2	+ 0.8	–58.6	– 3.8	– 3.8
Europe (FTSEurofirst 300)†	1,146.4	1,146.4	1,038.6	+ 1.2	–32.8	+10.0	– 1.8
Euro area (FTSE Euro 100)†	968.4	968.4	894.4	+ 1.2	–37.5	+ 7.5	– 4.1
World (MSCI)‡	1,165.0	1,193.0	1,115.0	+ 1.1	–19.6	– 0.4	– 0.4
World bond market (Citigroup)††	642.8	662.3	636.6	+ 0.9	– 2.9	– 3.5	– 3.5

*Total return index. †In euro terms. ‡Morgan Stanley Capital International index includes individual markets listed above plus eight others, in $ terms. ††Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Jun 23rd 2005
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	Trade balance*, $bn latest 12 months		Current-account balance $bn latest 12 mths		The Economist poll % of GDP, forecast 2005	2006	Exchange rate trade-weighted† 2000=100 Jun 22nd	year ago	Currency units per $ Jun 22nd	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2005‡
Australia	− 18.1	Apr	− 42.4	Q1	− 5.7	− 5.1	119.3	106.8	1.28	1.45	2.34	1.56	1.18	+ 0.9
Austria	nil	Mar	− 0.4	Mar	− 0.5	− 0.6	104.8§	103.6	0.82	0.83	1.50	–	0.76	− 2.0
Belgium	+ 16.7	Mar	+ 12.0	Dec	+ 3.3	+ 3.3	105.5§	103.9	0.82	0.83	1.50	–	0.76	− 0.5
Britain	−109.9	Apr	− 49.0	Q4	− 2.5	− 2.5	101.4	102.0	0.55	0.55	–	0.67	0.50	− 2.9
Canada	+ 49.1	Apr	+ 20.2	Q1	+ 1.7	+ 1.5	116.7	105.9	1.24	1.36	2.25	1.50	1.14	+ 1.2
Denmark	+ 9.2	Apr	+ 8.5	Apr	+ 2.1	+ 2.1	105.4	105.7	6.14	6.15	11.2	7.45	5.64	+ 1.8
France	− 22.4	Apr	− 19.4	Apr	− 0.3	− 0.1	108.3§	106.4	0.82	0.83	1.50	–	0.76	− 3.0
Germany	+198.5	Apr	+108.0	Apr	+ 3.4	+ 3.2	106.2§	104.0	0.82	0.83	1.50	–	0.76	− 3.5
Italy	− 6.1	Apr	− 19.0	Apr	− 1.2	− 1.2	77.5§	76.2	0.82	0.83	1.50	–	0.76	− 4.4
Japan	+125.3	Apr	+170.9	Apr	+ 3.6	+ 3.6	87.9	88.6	109	109	198	132	–	− 6.1
Netherlands	+ 38.7	Apr	+ 33.9	Q1	+ 3.4	+ 3.4	105.0§	103.2	0.82	0.83	1.50	–	0.76	− 2.2
Spain	− 83.1	Mar	− 55.5	Feb	− 4.9	− 4.9	77.8§	76.9	0.82	0.83	1.50	–	0.76	+ 0.5
Sweden	+ 23.0	Apr	+ 29.7	Q1	+ 6.9	+ 6.3	96.0	97.5	7.66	7.59	14.0	9.30	7.04	+ 0.8
Switzerland	+ 6.6	May	+ 40.8	Q4	+11.1	+10.5	106.6	108.5	1.27	1.25	2.32	1.54	1.17	− 1.0
United States	−709.7	Apr	−717.0	Q1	− 6.3	− 6.2	85.5	87.7	–	–	1.82	1.21	0.92	− 4.1
Euro area	+ 69.0	Apr	+ 42.1	Mar	+ 0.5	+ 0.5	114.3	114.1	0.82	0.83	1.50	–	0.76	− 2.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 12.6	Apr	+ 11.8	Apr	na	na	82.4§	81.0	0.82	0.83	1.50	–	0.76	+ 1.3
Greece	− 33.0	Mar	− 11.6	Apr	na	na	60.4§	59.6	0.82	0.83	1.50	–	0.76	− 3.8
Iceland	− 0.7	Apr	− 1.4	Q1	na	na	105.7**	98.7	65.7	72.7	120	79.6	60.3	+ 1.1
Ireland	+ 40.6	Apr	− 0.8	Q4	na	na	95.9§	93.2	0.82	0.83	1.50	–	0.76	− 0.7
Luxembourg	− 4.6	Mar	+ 2.9	Q4	na	na	105.5§	103.9	0.82	0.83	1.50	–	0.76	− 0.8
New Zealand	− 3.0	Apr	− 7.0	Q1	na	na	138.9	124.0	1.40	1.60	2.54	1.69	1.28	+ 3.2
Norway	+ 41.9	May	+ 37.9	Q1	na	na	110.2	103.4	6.49	6.93	11.8	7.87	5.96	+ 14.4
Portugal	− 19.6	Mar	− 13.9	Mar	na	na	94.3**	94.0	0.82	0.83	1.50	–	0.76	− 5.3

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, April average. ‡OECD forecast. ††New series.
**IMF, February average.

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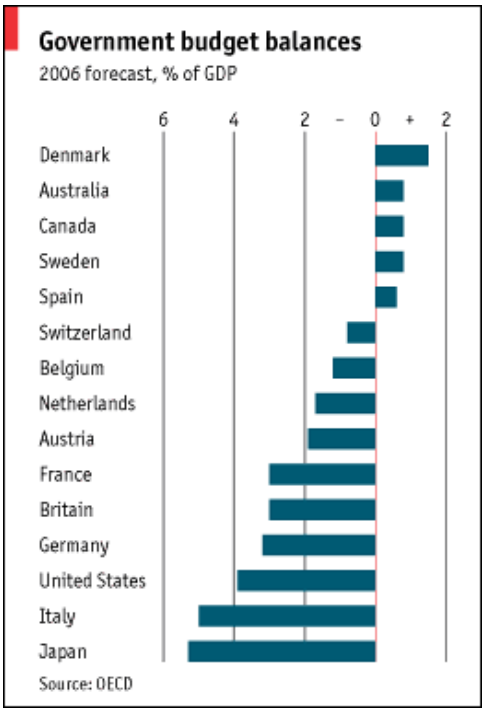
Government budget balances

Jun 23rd 2005
From The Economist print edition



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Overview

Jun 23rd 2005
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In **Argentina**, GDP increased by 8.0% in the year to the first quarter. In **Colombia**, industrial production rose by 4.5% in the 12 months to April.

The current-account surplus in **Brazil** shrank slightly to $13.4 billion in the year to May.

Russia's GDP grew by 5.2% in the year to the first quarter. It ran a trade surplus of $101 billion in the year to April.

India's trade deficit widened to $30.6 billion in the year to May. **Singapore** ran a trade surplus of $16.6 billion over the same period.

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Oil reserves

Jun 23rd 2005
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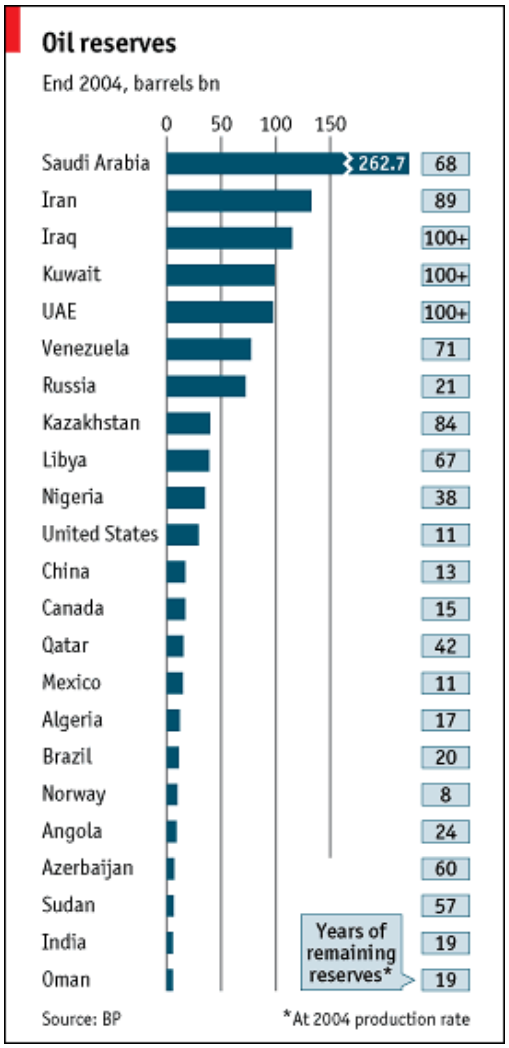
The world's proven oil reserves stand at just under 1.19 trillion barrels, reports BP in this year's Statistical Review of World Energy. Over 60% of this oil is in the Middle East. Saudi Arabia holds sway over 262.7 billion barrels of oil or 22% of proven reserves, by far the biggest share held by one country. But at its 2004 rate of production, Saudi Arabia will exhaust its reserves before Iran, in second place, with 132.5 billion barrels. Iraq has almost 10% of the world's proven oil reserves; Kuwait just over 8%. Outside the Middle East,Venezuela and Russia each hold around 6%.



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Economy

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	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.4	Q1	+16.6	May	+ 1.8	May	+71.1	May	+68.7	2004	659.1	Mar
Hong Kong	+ 6.0	Q1	+ 5.0	Q4	+ 0.5	Apr	−10.2	Apr	+16.4	Q4	122.4	May
India	+ 6.2	Q4	+ 8.8	Apr	+ 5.0	Apr	−30.6	May	− 3.9	Q4	134.0	May
Indonesia	+ 6.4	Q1	+10.1	Mar	+ 7.4	May	+27.5	Apr	+ 2.9	Q4	35.1	Apr
Malaysia	+ 5.7	Q1	+ 6.8	Apr	+ 3.1	May	+23.3	Apr	+15.1	Q4	73.0	Apr
Philippines	+ 4.6	Q1	+ 2.8	Mar	+ 8.5	May	nil	Mar	+ 2.1	Dec	14.8	May
Singapore	+ 2.5	Q1	+ 4.8	Apr	nil	May	+16.6	May	+29.2	Q1	116.0	May
South Korea	+ 2.7	Q1	+ 3.8	Apr	+ 3.1	May	+27.6	May	+25.4	Apr	206.0	May
Taiwan	+ 2.5	Q1	+ 0.6	Apr	+ 2.3	May	+ 2.6	May	+16.9	Q1	253.2	May
Thailand	+ 3.3	Q1	+ 5.1	Apr	+ 3.7	May	− 3.2	Apr	+ 2.0	Apr	48.1	Apr
Argentina	+ 8.0	Q1	+ 7.4	Apr	+ 8.6	May	+11.6	Apr	+ 3.0	Q4	20.1	Apr
Brazil	+ 2.9	Q1	+ 6.3	Apr	+ 8.1	May	+38.1	May	+13.4	May	61.1	Apr
Chile	+ 5.7	Q1	+10.1	Apr	+ 2.7	May	+ 8.6	May	+ 1.1	Q1	17.3	May
Colombia	+ 4.3	Q4	+ 4.5	Apr	+ 5.0	May	+ 0.8	Jan	− 1.1	Q4	12.2	May
Mexico	+ 2.4	Q1	+ 5.2	Apr	+ 4.6	May	− 9.8	Apr	− 8.7	Q1	62.8	Apr
Peru	+ 6.4	Apr	+ 7.1	Apr	+ 1.8	May	+ 3.3	Apr	+ 0.4	Q1	12.8	Apr
Venezuela	+ 7.9	Q1	+ 0.1	Mar	+17.4	May	+22.6	Q1	+14.9	Q1	19.9	Mar
Egypt	+ 4.7	Q4	+ 3.3	2004†	+ 5.6	Mar	− 9.0	Q4	+ 4.3	Q4	16.8	Apr
Israel	+ 3.9	Q1	+ 3.3	Mar	+ 0.2	May	− 7.2	May	+ 1.9	Q1	26.5	May
South Africa	+ 4.2	Q1	+ 7.1	Apr	+ 3.4	Apr	− 2.1	Apr	− 7.0	Q4	15.5	May
Czech Republic	+ 4.4	Q1	+ 5.7	Apr	+ 1.3	May	+ 0.5	Apr	− 4.4	Q1	27.1	May
Hungary	+ 2.9	Q1	+ 8.9	Apr	+ 3.6	May	− 2.9	Q4	− 8.8	Q4	17.5	May
Poland	+ 2.1	Q1	− 1.0	Apr	+ 2.5	May	− 4.9	Mar	− 2.8	Mar	39.3	Apr
Russia	+ 5.2	Q1	+ 1.4	May	+13.5	May	+101.0	Apr	+69.7	Q1	143.6	May
Turkey	+ 6.3	Q4	+ 5.1	Apr	+ 8.7	May	−36.3	Apr	−17.2	Apr	37.3	Apr
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+ 7.0	Q1	+11.3	Apr	+ 2.8	May	− 1.8	Mar	− 1.3	Apr	1.7	Apr
Latvia	+ 7.4	Q1	+ 4.3	Apr	+ 6.3	May	− 3.0	Apr	− 1.6	Apr	2.0	Apr
Lithuania	+ 5.6	Q1	na		+ 2.0	May	− 3.0	Apr	− 1.6	Q4	3.6	Apr
Slovakia	+ 5.1	Q1	+ 5.1	Apr	+ 2.4	May	− 1.9	Apr	− 1.8	Mar	17.6	Apr
Slovenia	+ 2.6	Q1	+ 3.7	Apr	+ 2.2	May	− 1.4	Apr	− 0.2	Apr	8.4	Mar
Pakistan	+ 6.4	2004†	+28.3	Nov	+ 9.8	May	− 6.2	May	− 1.5	Q1	10.7	Apr
Saudi Arabia	+ 5.2	2004	na		+ 0.6	Mar	+84.9	2004	+51.5	2004	22.9	Apr

*Excluding gold, except Singapore; IMF definition. †Year ending June.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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Financial markets

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	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Jun 22nd		Dec 31st 2004	
	Jun 22nd	year ago	Jun 22nd	% a year		one week	in local currency	in $ terms
China	8.28	8.28	15.1	2.50	1,157.4	+2.8	– 13.0	– 13.0
Hong Kong	7.77	7.80	14.2	3.23	14,113.3	+1.4	– 0.8	– 0.8
India	43.5	45.7	79.4	5.31	7,145.3	+3.5	+ 8.2	+ 8.0
Indonesia	9,650	9,423	17,587	8.34	1,134.7	+1.4	+ 13.4	+ 9.1
Malaysia	3.80	3.80	6.93	2.86	903.3	+0.3	– 0.5	– 0.5
Philippines	55.6	56.2	101.3	6.81	1,958.6	– 1.7	+ 7.4	+ 8.5
Singapore	1.67	1.72	3.05	2.06	2,206.3	+0.2	+ 6.8	+ 4.3
South Korea	1,011	1,160	1,842	3.52	1,002.2	nil	+ 11.9	+ 14.6
Taiwan	31.4	33.8	57.2	1.40	6,357.8	+1.7	+ 3.6	+ 4.6
Thailand	41.2	41.0	75.0	2.75	686.6	– 0.1	+ 2.8	– 3.0
Argentina	2.87	2.95	5.22	6.56	1,464.8	+0.8	+ 6.5	+ 10.5
Brazil	2.37	3.13	4.32	19.74	25,678.0	+0.8	– 2.0	+ 9.9
Chile	577	643	1,052	4.08	9,584.7	+2.1	+ 6.9	+ 2.9
Colombia	2,316	2,716	4,222	7.21	5,353.0	+3.6	+ 23.2	+ 25.1
Mexico	10.8	11.3	19.6	9.62	13,441.7	– 0.4	+ 4.1	+ 7.8
Peru	3.25	3.47	5.93	2.74	4,059.9	+1.8	+ 9.4	+ 10.3
Venezuela	2,686§	2,701§	4,895	11.19	21,581.1	– 2.3	– 27.9	– 30.8
Egypt	5.80	6.22	10.57	9.20	42,018.7	+7.8	+ 70.9	+ 78.9
Israel	4.53	4.51	8.25	3.49	672.5	– 2.0	+ 4.4	– 0.4
South Africa	6.72	6.25	12.3	7.05	14,313.5	+0.7	+ 13.1	– 5.2
Czech Republic	24.6	26.4	44.8	1.75	1,220.7	+2.0	+ 18.3	+ 7.4
Hungary	204	210	372	6.97	18,703.0	+1.5	+ 26.9	+ 12.3
Poland	3.32	3.77	6.06	5.20	28,394.3	+2.0	+ 6.6	– 4.0
Russia	28.6	29.0	52.1	13.00	695.9‡	+2.1	+ 16.8	+ 13.3
Turkey	1.35	1.49	2.47	16.54	26,779.3	+2.2	+ 7.2	+ 6.8
EM (MSCI)*	1.00	1.00	1.82	na	572.2	+1.7	+ 5.5	+ 5.5
EMBI+†	1.00	1.00	1.82	na	345.9	+1.2	+ 5.0	+ 5.0

*Emerging Mkts. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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